COMPLETED 202 Y4. F76/1: EX7/16

# OVERSIGHT OF THE EXPORT TRADING COMPANY ACT OF 1982

ORIGINAL

## HEARING

BEFORE THE

SUBCOMMITTEE ON INTERNATIONAL ECONOMIC POLICY AND TRADE

OF THE

## COMMITTEE ON FOREIGN AFFAIRS HOUSE OF REPRESENTATIVES

NINETY-EIGHTH CONGRESS

SECOND SESSION

JUNE 20; AUGUST 1; AND SEPTEMBER 20, 1984

Printed for the use of the Committee on Foreign Affairs

U.S. GOVERNMENT PRINTING OFFICE
57-212 O WASHINGTON : 1986

I
BEST COPY AVAILABLE

## COMMITTEE ON FOREIGN AFFAIRS

DANTE B. FASCELL, Florida, *Chairman*

LEE H. HAMILTON, Indiana
GUS YATRON, Pennsylvania
STEPHEN J. SOLARZ, New York
DON BONKER, Washington
GERRY E. STUDDS, Massachusetts
ANDY IRELAND, Florida
DAN MICA, Florida
MICHAEL D. BARNES, Maryland
HOWARD WOLPE, Michigan
GEO W. CROCKETT, JR., Michigan
SAM GEJDENSON, Connecticut
MERVYN M. DYMALLY, California
TOM LANTOS, California
PETER H. KOSTMAYER, Pennsylvania
ROBERT G. TORRICELLI, New Jersey
LAWRENCE J. SMITH, Florida
HOWARD L. BERMAN, California
HARRY REID, Nevada
MEL LEVINE, California
EDWARD F. FEIGHAN, Ohio
TED WEISS, New York
GARY L. ACKERMAN, New York
ROBERT GARCIA, New York

WILLIAM S. BROOMFIELD, Michigan
LARRY WINN, JR., Kansas
BENJAMIN A. GILMAN, New York
ROBERT J. LAGOMARSINO, California
JOEL PRITCHARD, Washington
JIM LEACH, Iowa
TOBY ROTH, Wisconsin
OLYMPIA J. SNOWE, Maine
HENRY J. HYDE, Illinois
GERALD B.H. SOLOMON, New York
DOUGLAS K. BEREUTER, Nebraska
MARK D. SILJANDER, Michigan
ED ZSCHAU, California

JOHN J. BRADY, JR., *Chief of Staff*
SUE E. ECKERT, *Staff Assistant*

---

### SUBCOMMITTEE ON INTERNATIONAL ECONOMIC POLICY AND TRADE

DON BONKER, Washington, *Chairman*

DAN MICA, Florida
HOWARD L. BERMAN, California
EDWARD F. FEIGHAN, Ohio
MICHAEL D. BARNES, Maryland
HOWARD WOLPE, Michigan
SAM GEJDENSON, Connecticut

TOBY ROTH, Wisconsin
OLYMPIA J. SNOWE, Maine
DOUGLAS K. BEREUTER, Nebraska

R. ROGER MAJAK, *Subcommittee Staff Director*
JENNIFER J. WHITE, *Minority Staff Consultant*
CAROL PAGE ROVNER, *Subcommittee Staff Consultant*
CAROLE A. GRUNBERG, *Subcommittee Staff Consultant*



BEST COPY AVAILABLE

# CONTENTS

## WITNESSES


| | Page |
|---|---|
| Wednesday, June 20, 1984: | |
| Charles S. Warner, Director, Office of Export Trading Company Affairs, Department of Commerce, accompanied by Irving P. Margulies, general counsel, Department of Commerce | 2 |
| Frederick R. Dahl, Associate Director, Division of Banking Supervision and Regulation, Board of Governors, Federal Reserve System | 34 |
| Wednesday, August 1, 1984: | |
| William H. Draper III, president and chairman, Export-Import Bank | 70 |
| Charles F. Rule, Deputy Assistant Attorney General, Antitrust Division, Department of Justice | 91 |
| Arthur P. Sultan, chief administrative officer, Citicorp International Trading Co., Inc | 114 |
| Thursday, September 20, 1984: | |
| Edward J. Roach, vice president, international controls, Honeywell, Inc., and chairman of the board, Honeywell High-Tech Trading, Inc | 150 |
| Robert E. Gomperts, senior vice president, BankAmerica World Trade Corp | 153 |
| George H. Becker, Jr., corporate director, Bancorps International Trading Corp | 171 |
| Richard L. Barovick, editor and publisher, International Trade and Investment Letter | 174 |




BEST COPY AVAILABLE

# OVERSIGHT OF THE EXPORT TRADING COMPANY ACT OF 1982

WEDNESDAY, JUNE 20, 1984

HOUSE OF REPRESENTATIVES,
COMMITTEE ON FOREIGN AFFAIRS,
SUBCOMMITTEE ON INTERNATIONAL
ECONOMIC POLICY AND TRADE,
*Washington, DC.*

The subcommittee met at 2:15 p.m., in room 2255, Rayburn House Office Building, Hon. Don Bonker (chairman of the subcommittee) presiding.

Mr. BONKER. The subcommittee will come to order.

This is the Subcommittee on International Economic Policy and Trade. Today we begin a series of oversight hearings on the Export Trading Company Act of 1982. This law has been in place for more than a year and I think now is a good time for us to review the progress that has been made as a result of Congress taking this step.

Many of us who supported the export trading company's [ETC] legislation had hoped that ETC's would revolutionize trade for America and make available new export opportunities for small and medium-sized companies who, in the past, did not have access to world markets. We attempted to do this by way of allowing banks to participate in the formation of export trading companies, thereby providing export-related services to a variety of businesses who are anxious to explore new opportunities abroad. We also made it possible for small and medium-sized companies to collaborate on joint export efforts without fear of antitrust violations, thereby creating new opportunities as a result of collective action. The purpose of these hearings is to review the record of ETC's formation over the past 18 months.

I will note that many of the large multinational corporations have formed ETC's, but that type of ETC development is not directly related to the legislation. Some of these large companies in dealing with the economic realities of countertrade and other developments in the global marketplace have formed ETC's as a way to reorganize their corporate structure in order to have the necessary flexibility to deal with these new realities.

The small and medium-sized companies have not moved in forming trading companies as we would have hoped in the early stages. I think this is due to business caution and the lack of what I thought would be a pioneering spirit in getting small and medium-sized companies to rush to the Department of Commerce with their



BEST COPY AVAILABLE

certification requests. That hasn't really happened. The banks, however, are moving in this direction, at least on the west coast. Many of them have been certified by the Federal Reserve Board and, while they are moving cautiously, they are setting up the ETC's so they will have the flexibility to provide export services to companies in the future.

We are going to hear today from government witnesses, primarily from the Department of Commerce, which is the lead agency in this matter; but also from the Federal Reserve System. The law grants authority to both agencies: Commerce is to process the applications for the small and medium-sized companies, and the Federal Reserve Board is to have lead responsibility in terms of bank certifications.

Witnesses from both agencies are here today. We are going to deal primarily with the record, things that have happened, with little focus on policy matters. We will save that for later on once the committee has developed a base of information for looking at the Export Trading Company Act.

Mr. Bereuter, do you have any opening comments?

Mr. BEREUTER. Mr. Chairman, I am just pleased that you have scheduled this oversight hearing today on the export trading companies. You are to be commended for it. I look forward to the testimony today.

Mr. BONKER. I would have scheduled it 6 months ago if we had disposed of the Export Administration Act.

Mr. BEREUTER. I understand that. [Laughter.]

Mr. BONKER. Would the witnesses please come to the witness table? We have before us today Charles Warner and Frederick Dahl. Mr. Warner is the Director of the Office of Export Trading Company Affairs in the Department of Commerce; and Frederick Dahl is the Associate Director, Division of Banking Supervision and Regulation, for the Federal Reserve Board.

Before I call upon the witnesses, Ms. Snowe, do you have an opening comment?

Ms. SNOWE. No; I don't. Thank you, Mr. Chairman.

Mr. BONKER. We will proceed first with Mr. Warner and then hear from Mr. Dahl, and then we will open for questions.

## STATEMENT OF CHARLES S. WARNER, DIRECTOR, OFFICE OF EXPORT TRADING COMPANY AFFAIRS, DEPARTMENT OF COMMERCE, ACCOMPANIED BY IRVING P. MARGULIES, GENERAL COUNSEL, DEPARTMENT OF COMMERCE

Mr. WARNER. Thank you, Mr. Chairman. It is a pleasure to be here and have an opportunity to speak for the Commerce Department. On behalf of Commerce, let us extend to you again our thanks for your ardent support through the legislative period and afterward for this what we think is a landmark piece of legislation. Perhaps after today's hearing, you will have a stronger feeling as to the trend and the potential strength and the effect of this act.

I am Charles Warner, Director of the Office of Export Trading Company Affairs, International Trade Administration, U.S. Department of Commerce. I will summarize my statement, Mr. Chairman.

BEST COPY AVAILABLE

Mr. BONKER. Thank you, Mr. Warner. We love to have statements summarized.

Mr. WARNER. I understand that.

Appearing with me is Irving P. Margulies, general counsel of the Department of Commerce.

### DEPARTMENT OF COMMERCE ROLE

The Department recognizes its position as the lead Federal agency responsible for the implementation of this landmark legislation and, in particular, the administration of titles I and III. The Office of Export Trading Company Affairs has been established within the International Trade Administration and is actively engaged in promoting the formation of export trading companies, providing advice and counsel to potential users of the act, maintaining a contact facilitation service, and processing the applications for antitrust protection under export trade certificates of review.

The Department has followed its mandate to promote with total commitment. In fiscal year 1983, we initiated a nationwide series of conferences attended by over 12,000 conferees.

Continuing this momentum, we scheduled a second round of conferences that are cosponsored with major U.S. accounting firms. This current series of conferences has provided technical guidance to those persons seriously interested in forming and/or using export trading companies. Each conference includes a discussion of legal issues, business planning, international trade finance transactions and Government assistance to exporters. Significantly, very qualified private sector speakers and panelists have participated in these conferences and have given the needed perspective of active practitioners. Nearly 25,000 information kits were distributed concurrent with this promotional activity.

Further, we have actively supported and participated in conferences sponsored by such organizations as the National League of Cities, the National Association of Regional Councils, the National Conference of State Legislators, and many conferences sponsored by trade and industry associations.

Because we view the act as a significant economic development tool, we have maintained an aggressive outreach program with the public sector, particularly at the State, sub-State, and local level.

### APPLICATIONS FOR ETC CERTIFICATION

Since the legislation was enacted in October 1982, the Office of Export Trading Company Affairs has conducted more than 300 individualized counseling sessions with firms, trade associations, banks, industry representatives, and other persons interested in forming or using ETC's. Although a number of these counseling sessions have involved large or multinational corporate entities, the majority were attended by small- and medium-sized business organizations. In almost all instances, these meetings included a discussion of the antitrust provisions of titles III and IV and various arrangements which could be considered for title III certification. In addition, many of the counseling sessions included discussion of ETC organizational issues and, importantly, international trade finance questions.

BEST COPY AVAILABLE

Export trade certificates of review issued to date have established consequential legal and economic precedents in antitrust analysis. It is too early to fully measure the impact of these precedents. However, we believe many competent observers will acknowledge the significance of this beginning.

Pursuant to title III, important progress has been made in clarifying the application of U.S. antitrust laws to export activity. The Department's title III regulations have been in effect for just 1 year, yet have already received 60 applications for export trade certificates. To date, 28 certificates have been issued, and we anticipate that approximately 40 to 45 will be issued by the end of this fiscal year.

Mr. BONKER. Would you give us those figures again, Mr. Warner?

Mr. WARNER. We have received 60 applications; we have issued 28.

Mr. BONKER. Sixty applications.

Mr. WARNER. Yes, sir.

Mr. BONKER. And you certified 28.

Mr. WARNER. That is correct.

Mr. BONKER. OK. Is that this year, or is that since the inception of the program?

Mr. WARNER. That is since the inception of the program. The first certificates of review were accepted on the 9th of June, 1983.

Mr. BONKER. OK.

Mr. WARNER. In sum, the substance and complexity of the applications are increasing proportionate to program experience. Important precedents have been set by these first certificates. Business planners have new horizons open to them, especially in the area of joint export activities where they can achieve economies of scale and minimization of individual risk. The export trade certificate of review is an important new export tool which can sharpen the competitiveness of U.S. exporters.

### BANKING SYSTEM RESPONSE TO ETC ACT

Recent public commentary would lead one to believe the American banking system has given only token response to the vast opportunities afforded by this act. By any reasonable appraisal, informed opinion would note carefully that of the 14,000-plus universe of banking institutions in the United States at the time of this act, only a small fraction had sufficient experience in trade finance and trade facilitation services to immediately offer the broad support contemplated in title II.

Commerce has never viewed quantity above substance as a measure of sound response under titles II or III. A more appropriate view is the value of the qualitative aspects of the present and prospective commitments by the banks. It is a reasonable beginning.

Mr. BONKER. I am sorry. Would you repeat that please. Quality above substance?

Mr. WARNER. Yes, sir.

Mr. BONKER. What do you mean by that?

Mr. WARNER. It is not the number of banks that have necessarily pursued the export trading company affiliate formation but, in our view, in addition to number, it is the qualitative aspects of devota-

BEST COPY AVAILABLE

tion of bank resources, the management that they have put into these trading companies——

Mr. BONKER. Why are you getting into the banking side of the issue?

Mr. WARNER. Because we have the responsibility to promote them, sir.

Mr. BONKER. Only from the promotional side?

Mr. WARNER. That is correct, sir.

Mr. BONKER. Approval of bank ETC's responsibility.

Mr. WARNER. Well, I am trying to address it as positively as I possibly can.

May I continue?

Mr. BONKER. Proceed.

Mr. WARNER. Thank you, sir.

It is a reasonable beginning, yet it can be greatly enhanced as policies so clearly set out in section 202 are fulfilled. The United States is at a crossroad of trade flow and trade finance issues that serves to emphasize even further the findings and intent of the Congress in making this new law.

That the U.S. banking system is afforded and consequently maintains through its export trading companies those powers sufficiently broad to enable them to compete with similar foreign-owned institutions in the United States and abroad is critical to the further development of a stronger competitive response for the American enterprise system to present and foreseeable world trade conditions.

I appreciate this opportunity to summarize, Mr. Chairman. That concludes my statement.

[Mr. Warner's prepared statement follows:]

BEST COPY AVAILABLE

**PREPARED STATEMENT OF CHARLES S. WARNER, DIRECTOR, OFFICE OF EXPORT TRADING COMPANY AFFAIRS, INTERNATIONAL TRADE ADMINISTRATION, DEPARTMENT OF COMMERCE**

Mr. Chairman and members of the Committee, I am Charles S. Warner, Director of the Office of Export Trading Company Affairs, International Trade Administration, Department of Commerce. I am pleased to have this opportunity to report on the role the Department of Commerce has played in the implementation and administration of the Export Trading Company Act of 1982 (ETC Act). Appearing with me this morning is Irving P. Margulies, General Counsel of the Department of Commerce.

The Department recognizes its position as the lead Federal agency responsible for the implementation of this landmark legislation and, in particular, the administration of Titles I and III. The Office of Export Trading Company Affairs (OETCA) has been established within the International Trade Administration and is actively engaged in promoting the formation of export trading companies (ETCs); providing advice and counsel to potential users of the Act; maintaining a contact facilitation service; and processing applications for antitrust protection under Export Trade Certificates of Review.

Promotion

Immediately after passage of the Act and continuing through fiscal year 1983, the Department initiated 49 ETC conferences nationwide to inform the public of the legislation and the significant opportunities which it offers American businesses to increase their competitiveness in the international market place. During this first round of conferences over 12,000 attendees were informed of the Act and the services provided by OETCA.

BEST COPY AVAILABLE

During fiscal year 1984, OETCA has scheduled a second round of nationwide conferences that are co-sponsored with major U.S. accounting firms. This current series of conferences has provided technical guidance to those persons seriously interested in forming and/or using an ETC. Each conference includes a discussion of legal issues, business planning, financing international trade transactions and government assistance to exporters. Significantly, very qualified private sector speakers and panelists have participated in these conferences and given the needed perspective of active practitioners.

Since the beginning of the ETC program the Department has distributed nearly 25,000 information kits containing copies of the Act, the Department of Commerce's regulations and guidelines, the Federal Reserve Board's regulations, and materials explaining the EXIMBANK program, the Contact Facilitation Service and other related government assistance programs.

In March of this year we published the Export Trading Company Guidebook which, in addition to explaining the provisions of the Act, provides a discussion of the interaction between ETC organizational variables and such cost considerations as transportation expenses, personnel, capitalization and growth plans. Copies of the Guidebook have been sent to all of the ITA District Offices and we anticipate that the original 10,000 copies will be fully distributed by the end of this fiscal year.

In addition to the general conferences co-sponsored with the accounting firms, OETCA has conducted industry specific ETC conferences in Washington, D.C. for the banking and coal industries. Further, we have actively supported and participated in

BEST COPY AVAILABLE

conferences sponsored by such organizations as the National League of Cities, the National Association of Regional Councils, the National Conference of State Legislators and many conferences sponsored by trade and industry associations. Most recently OETCA has participated in the preparation of a short film on ETCs for showing at the Louisiana World's Fair.

Because we view the ETC Act as a significant economic development tool, we have maintained an aggressive outreach program with the public sector, particularly at the state, substate, and local level.

One indication of how effective the Department's promotion efforts have been is reflected in a survey conducted by the National Center for Export-Import Studies, Georgetown University. This study concludes that a substantial majority of firms interested in international trade is familiar with the ETC Act and expects it to improve U.S. export performance. Of the three major groups of survey respondents, bankers are the most familiar with 97 percent stating that they had heard about the Act. Next were export service providers with over 90 percent indicating they knew of the Act. Although manufacturers were the least familiar within the three respondent groups, still 78 percent stated that they had heard about the ETC Act.

BEST COPY AVAILABLE

Counseling

Since the legislation was enacted in October 1982, OETCA has conducted more than 300 individualized counseling sessions with firms, trade associations, banks, industry representatives and other persons interested in forming or using ETCs. Although a number of these counseling sessions involved large U.S. or multinational corporate entities, the majority were attended by small and medium-sized business organizations. In almost all instances these meetings included a discussion of the antitrust provisions of Titles III and IV and various arrangements which could be considered for Title III certification. In addition, many of the counseling sessions included discussion of ETC organizational issues and international trade finance.

Contact Facilitation Service

The Department, as part of its responsibility to promote ETCs and to carry out the provisions of Section 104 of the Act, has established a Contact Facilitation Service ("CFS") which is available through all of the Department's 47 District Offices. The CFS is computer based and is designed to facilitate contact between U.S. producers of exportable goods and services and firms offering export trade services. Companies or individuals who wish to form an ETC may also use the CFS to identify others who are interested in establishing an export trading company. Over 2,000 firms representing more than

BEST COPY AVAILABLE

3,000 product lines have registered with the CFS. Of these registrants approximately 52 percent are manufacturers/producers; 44 percent are ETCs, export management companies or export service companies; and 4 percent are banks.

As originally designed, a CFS user would request a computer search based on predetermined identifying characteristics of firms and/or products. For example, a search of all manufacturers of electrocardiograph machines located in a specified 5 state area of the northeast. In addition to paying a flat fee for the search, the requesting party would also be charged a fee for each name produced by the search.

Because this process was significantly underutilized, OETCA has changed the format and published the entire data base in book form. Copies of the CFS published data base will be made available to potential users through the ITA District Offices.

Export Trade Certificates of Review

In passing the Export Trading Company Act of 1982 Congress recognized the need to remove the uncertain application of U.S. antitrust laws as a perceived impediment to export activities and, in particular, joint export activities involving domestic competitors. Export Trade Certificates of Review issued to date have established consequential legal and economic precedents in antitrust analysis. It is too early to fully measure the impact of

BEST COPY AVAILABLE

these precedents. However, we believe many competent observers will acknowledge the significance of this beginning. The International Trade Administration has received the highest level of support from the Office of General Counsel in the course of its full implementation of Title III. The General Counsel's role has been critical in obtaining the concurrence of the Department of Justice in each certificate.

Pursuant to Title III important progress has been made in clarifying the application of U.S. antitrust laws to export activity. The Department's Title III regulations have been in effect for just one year and yet we have already received 60 applications for export trade certificates of review. To date 28 certificates have been issued and we anticipate that approximately 40-45 will be issued by the end of this fiscal year. Significantly, no application has been denied.

To date the majority of applicants seeking antitrust protection have been small and medium-sized firms. Many of these applicants do not manufacture or produce goods for export but rather plan on becoming export trade intermediaries. However, a number of certificates have been approved for groups of domestic competitors that will be engaging in joint export activities to take advantage of the economies of scale and the sharing of risk that can result from cooperative efforts in the overseas market. Our counseling experience and a review of recent application filings indicate the

BEST COPY AVAILABLE

percentage of applications involving joint ventures and joint export activities on the part of domestic competitors will increase.

Many of the initial applications received by OETCA were too incomplete to be accepted for processing. This trend has now been reversed and we are experiencing a marked reduction in the number of deficient applications. We believe this is a result of several factors including greater familiarity with the application form itself; increased pre-application counseling by our office; more involvement by the legal community assisting clients in seeking antitrust protection; and the trend toward submissions by more sophisticated applicants. These more recent applications have also presented both Commerce and the Department of Justice with more substantive issues of antitrust law and economics.

Through use of the expedited review process the Department has also demonstrated that where circumstances warrant special processing procedures, we can respond quickly to the needs of the business community. The first request for expedited review was granted to a California rice cooperative that wanted to pool its supplies with other firms for a joint sale overseas. The applicant requested expedited review based on its knowledge that a Far East government would be soliciting bids on a substantial commercial contract for rice and that the deadline for submission bids would be short. The Departments of Commerce and Justice agreed to grant expedited review

BEST COPY AVAILABLE

after concluding that the contract would represent a significant export transaction for the consortia should it win the contract and that given the likely bid schedule the normal 90 day processing time could preclude submission of the joint bid. The second request for expedited review was granted to a group of woodchip suppliers located in the southeast who, like the rice cooperative, wanted to pool their supplies for an overseas transaction. Both of these certificates have been issued and will afford the antitrust protections sought by the applicants.

In March, 1984, Commerce, with the concurrence of the Department of Justice, issued its first certificate of review to a public sector applicant. VEXTRAC, Ltd., is a non-profit corporation formed and controlled by the Virginia Port Authority. By providing marketing, financial and transportation services, VEXTRAC seeks to promote the export of goods and services produced in the Commonwealth of Virginia. Under the antitrust protection of its certificate, VEXTRAC can collect and analyze business information from individual competing producers to determine the feasibility of joint export ventures. The certificate also allows VEXTRAC to require exporters that use its services to export through Virginia ports and to use VEXTRAC as their intermediary in arranging financing and transportation services. We expect to see more public sector organizations formed as various jurisdictions begin to recognize the significance of the Act as an economic development tool.

BEST COPY AVAILABLE

These early certificates provide protection to a broad range of export activities which could give rise to antitrust concerns. Examples of export conduct certified to date include: exclusive sales or marketing agreements with domestic suppliers; exclusive foreign distributor and marketing arrangements; agreements on fixing prices for export and maintaining resale prices; allocations of quotas for export; allocation of export markets, territories or customers; refusals to deal; exchange of price and other business information; and restrictions on membership and on withdrawal from membership. Activities such as these, which improve the competitive position of U.S. exporters, are what Congress contemplated in modifying the application of the antitrust laws to certain export trade by passing the Act.

The Department is currently working with the Department of Justice in reviewing proposed final regulations for the export trade certificate of review program (OETCA has been operating under interim regulations since June 9, 1983). Similarly we are in the process of revising the Title III Guidelines to reflect our first year of experience. We anticipate forwarding the draft second edition of the Guidelines to Justice for concurrence within the next few weeks.

BEST COPY AVAILABLE

In sum, the substance and complexity of the applications are increasing proportionate to program experience. Important precedents have been set by these first certificates. Business planners have new horizons open to them especially in the area of joint export activities where they can achieve economies of scale and minimization of individual risk. The export trade certificate of review is an important new export tool which can sharpen the competitiveness of U.S. exporters.

Bank ETCs

In enacting the Export Trading Company Act of 1982, Congress determined that if United States trading companies were to be successful in promoting United States exports and in competing with foreign trading companies, they would have to draw on the resources, expertise and knowledge of the United States banking system, both in the United States and abroad. ITA has consistently and vigorously promoted the formation of ETCs by the banking industry. Promotion and counseling activities have fully embraced the policy guidelines provided in Section 202 of the Act.

A year's experience under the Federal Reserve Board regulations which implement Title II of the ETC Act, the "Bank Export Services Act" indicates the banking industry is a willing partner in the effort to increase the United States' export capability through the formation of ETCs. As of June 1, 1984, 24 bank holding companies

BEST COPY AVAILABLE

(BHCs) had received approval of their ETC investments from the Federal Reserve Board. Three other applications were pending. With over 14,000 banks across the country, 27 bank ETCs may not seem much of a response. However the number of U.S. banks with mature, sophisticated, international experience and the capability to form and operate an ETC is closer to 200. A 15 percent response, during a world-wide economic recession and with the high value of the dollar adversely affecting U.S. exports, is impressive.
Thirty-eight percent of the BHC/ETCs are wholly owned subsidiaries of money-center banks (Security Pacific, Citicorp, Crocker, First Chicago, Shanghi Hong Kong, Bank of America, Chase Manhattan, Bankers Trust, Manufacturers Hanover). Forty-two percent are wholly owned subsidiaries of regional BHCs (First National State, First Interstate, First Kentucky, Union, State Street, International Banshares, First National Banshares, Fleet, First Union). The remaining 20 percent are either joint ventures between a commercial entity and a regional BHC or acquisitions of existing trading companies by a regional BHC (BITCO, United Midwest, U.S. Bancorp, Rainier, Shawmut, Society Corp.).

Under the Federal Reserve Board's regulations these ETCs will be acting as facilitators of the export of goods and services of unaffiliated persons. Some will offer a full range of export trade services, others will concentrate on certain areas. i.e., market research, countertrade, consulting, insurance.

BEST COPY AVAILABLE

BHCs appear to be investing in ETCs for three reasons: (1) to generate more non-bank activity profit centers; (2) to increase the array of services which they can provide to their present and potential customers; and (3) to aggressively pursue new opportunities under this deregulatory legislation.

All BHC/ETCs appear to be targeting middle market companies ($100 million or less) with export potential as their clientele.

One developing trend is the use of the joint venture or acquisition by the regional BHC. Some will have multi-ETC joint ventures by product line, by export market, or by geographic considerations. This joint activity by commercial interests and BHCs was one of the hoped for effects of Title II by Congress. From our discussions with various members of the banking industry we believe that many more regional BHCs will be establishing ETCs in the near future.

Although Title II is administered primarily by the Federal Reserve Board, the Department of Commerce continues to work closely with the banking community to encourage their participation in the formation of ETCs. For example, in September 1983, Commerce and the Treasury Department co-sponsored a one day bank ETC conference which was attended by 454 representatives of banks throughout the United States. Consideration is being given to holding a similar conference on the West Coast sometime this fall.

BEST COPY AVAILABLE

That completes our general assessment on the progress of the implementation of the Act. The Committee also requested a discussion of specific topics outlined in the Chairman's letter to Under Secretary Lionel Olmer of June 7, 1984. Our discussion of those items follows in order.

1. Brief summary of the applications received and certificates granted to date and any trends as to companies and products which have emerged.

Since the beginning of the program on June 9, 1983, OETCA has received 60 applications for certificates of review. Twenty-eight certificates have been granted. Eleven are in process. None have been denied.

In terms of size, five applicants whose applications were accepted for processing, had annual sales in excess of $100 million, eight had annual sales between $10 and $50 million, and the remainder had annual sales less than $10 million.

As for types of organizations, those who have applied include five producers of raw materials or commodities, six producers of finished goods, six producers of services, six producers of both products and services, a public entity, five with a relationship with a trade association and three existing Webb-Pomerene Associations.

BEST COPY AVAILABLE

The type of conduct certified includes: exclusive agreements with suppliers of export products which the applicant does not produce; exclusive agreements with suppliers of export products which the applicant does produce; exclusive agreements with distributors in export markets; price setting in export markets; quota or quantity restrictions on exports; allocation of customers or territories in export markets; joint selling arrangements among several suppliers that are in the same business; refusal to deal provisions or agreements with U.S. suppliers; refusal to deal provisions or agreements with distributors in export markets; and exchange of business information in preparation of bids for overseas contracts. The products in which the applicants trade cover a broad spectrum.

2. Discussion of any problems/obstacles which have arisen in implementation of the Act.

Direct implementation by the Department of Commerce has proceeded in a timely and effective manner. Indirect or external factors have, however, influenced the ultimate goals of the program for this first year. Since the Fall of 1982 a worldwide recession, disparate valuations of major exchange currencies, intensified price competition in world markets, with attendant trade finance considerations and the uneven economic recovery from the worldwide recession with the incumbent residual third world debt issues have clearly impacted the fundamental industry beneficiaries of the Act.

BEST COPY AVAILABLE

Importantly, despite the effects of these conditions on U.S. exporters and export facilitators, many of the basic values of this Act have been pursued and are now further visualized as significant tools by which the U.S. enterprise system can deal more effectively with these very conditions affecting international trade.

The Department of Commerce has sought the broadest possible interpretation of the Act and, as lead Federal agency, has pursued the implementation process so as to maximize its effect on U.S. export trade operations. However, as might be expected, the four implementing agencies (Commerce, Justice, the Federal Reserve Board and Eximbank) all have different perspectives on how the statutory provisions should be carried out. Because of its export promotion orientation, the Department of Commerce has been the most aggressive in pushing for generous, pro-exporter interpretations of the law. The other agencies have had more conservative views, perhaps growing out of their traditional roles as enforcement, regulatory or lending authorities. These differences seem inherent in the statute as presently structured and indeed may have been intended by Congress to create a set of checks and balances for ETC development in this country.

BEST COPY AVAILABLE

3. Estimate the current trading company mortality rate, and the reason for trading company failures.

The question infers a high rate of failure in the trading company industry. We are not aware of any such condition. As mentioned above the economic conditions we have been faced with over the past two years have adversely affected U.S. competitiveness in world markets. The economic downturn has been felt by the most experienced trading companies around the world.

Establishing a successful export operation is not a short term proposition. Several years of operating losses are not uncommon for firms entering export markets. It is much too early to render judgment on U.S. firms' efforts to penetrate new markets since the Act was passed.

4. Reasons for the lengthy time for issuance of the regulations, and mediocre response by business.

The ETC Act was passed by Congress on October 1, 1982 and signed by the President on October 8. The Department of Commerce issued proposed regulations on December 21, 1982 and interim (effective) regulations on March 11, 1983. We were required by law to have a public comment period and to have the concurrence of Justice on both issuances. Given these facts, effective regulations were available sooner than most thought possible. (We could not begin accepting

BEST COPY AVAILABLE

applications until June 9, 1983, because the ETC Act itself contained a 90-day delay period for the start up of the program after the issuance of effective regulations.)

The interim regulations have been very successful in operating the program for over a year and we have received almost no negative reaction from the public. However, we are currently negotiating with Justice to issue final regulations in the next month or so. These regulations will clarify some matters for the public and further refine the mechanics of the relationship between Commerce and Justice in the program.

A judgment that the response of business to Title III has been mediocre is much too premature. As outlined above we think this program has made significant progress. In a year's time we have issued regulations, established an office to administer the program, received 60 applications, issued 28 certificates and had individual counseling sessions regarding the antitrust provision of the Act with over 300 companies. Like any new product, the certification program is undergoing an "acceptance" review by the business community. Many of the firms that have been counseled have been waiting to see how the initial certificates turned out. With a track record beginning to be established these firms are beginning to come forth with business plans stimulated by the protection afforded by a certificate.

BEST COPY AVAILABLE

5. The impact of increased use of countertrade on export trading companies.

Although countertrade is a barrier to a truly free trading system, it has become a reality of the international marketplace as more countries with currency imbalances impose countertrade requirements on import transactions. This development could have a positive impact on trading companies since they will be the likely vehicle for an exporter or manufacturer to use in handling countertrade transactions. The capacity and expertise required to successfully handle countertrade situations are considerable. Often a countertrade transaction will be beyond the capability of the individual exporter and the trading companies will likely play a major role in this area.

6. Review the practical effects of the various operating limits on trading companies set forth in the Act, such as they 50 percent provision exemption from 23A of the Banking Act (sic), etc.

As indicated above the Department has vigorously promoted the formation of ETCs by the banking industry. We agree with the Congressional finding that if U.S. trading companies are to be successful they must be able to draw on the resources, expertise, and knowledge of the U.S. banking system. We further believe that if the bank ETCs are to reach the Congressional goal of having powers broad enough to compete with similar foreign owned

BEST COPY AVAILABLE

institutions, that the Federal Reserve Board regulations will have to be examined periodically to determine if they are facilitating the achievement of this goal. At this point it is probably too early to tell as no bank ETC has experienced a year of operations.

7. Review the extent of market share of trading companies so far given antitrust certifications, and the factors considered in justifying such market concentrations.

Of the 28 certificates issued to date, only 2 have been issued to ETCs whose membership is comprised of direct U.S. competitors that collectively constitute a large domestic market share. These are: (1) Farmers' Rice Cooperative (FRC), and (2) Northwest Fruit Exporters (NFE). In the case of FRC, the U.S. market share is approximately 50 percent, where the market is defined geographically as California and the product simply as rice. Despite the 50 percent market share, certification was justified for several reasons: (1) The geographic borders of the relevant market were found to be weak as evidenced by the fact that approximately half of rice consumed in California is "imported" from the other major producing region in the U.S., the South. (2) Many U.S. buyers of U.S. rice are large and sophisticated, e.g., the food processing and brewing industries, whose large purchases present powerful forces against non-competitive pricing. (3) The bulk of California grown rice is exported. (4) The ETC does not bring about an actual merger of its members. And (5) the certificate included provisions that preclude the exchange of competitively sensitive information.

BEST COPY AVAILABLE

In the case of NFE, the ETC membership makes up approximately 75 percent of the U.S. fresh sweet cherry processing industry. Certification was, nonetheless, justified for five chief reasons: (1) The ETC's membership is comprised of 25 firms. Despite the large share of fresh sweet cherry processing capacity in the ETC, the U.S. industry is only minimally concentrated. That is, it took 25 firms to get to the 75 percent. (2) There exists at least 25 other processors in the region where the ETC members are located. These other processors have the capability to expand output readily, and thus offer on-going competitive pressures. (3) Entry conditions in the fresh sweet cherry processing business (packing and shipping) are not conducive to non-competitive pricing. Entry is easy, with minimal capital and time requirements. This is a case where the "long-run" is actually quite "short." Thus, non-competitive pricing in the U.S. could not be sustained, as opportunities for profit would attract an influx of new entrants driving price down. (4) The ETC does not bring about an actual merger of its members. And (5) the certificate included provisions that preclude the exchange of competitively sensitive information. It is also important to note that the NFE ETC presents a clear case of using the trading company concept to confront a major foreign non-tariff trade barrier (the Japanese inspection requirements) that individual sweet cherry processors could not have overcome alone.

BEST COPY AVAILABLE

8. What can be done to encourage formation of more trading companies specializing in export services?

Many of the newly established trading companies are in the service area either solely or as a major portion of their trading activity. As outlined above several of our certificate holders are in the service area. Several of the bank ETCs are also concentrating in services as well as the general trading companies formed by several U.S. multinational firms.

In ITA's recent reorganization a new sector was established to deal directly with the service industry and ETCs. This sector will play a major role in promoting the export of services through the ETC mechanism.

9. Review any available data or estimates of the dollar value of private export financing that has been generated by bank-affiliated trading companies to date.

This information is not available to our office at this time.

I would again like to introduce Irving P. Margulies, the Department's General Counsel, who will assist me in answering your questions which touch upon the legal issues arising under the Act.

Mr. Chairman this completes my prepared remarks. I will be pleased to answer any questions you or members of the Committee may have now or in the future.

BEST COPY AVAILABLE

Mr. BONKER. Thank you, Mr. Warner.

I think we will proceed with questions and cover the Commerce side, and then we will hear from Mr. Dahl and cover the finance side.

Mr. WARNER. Yes, sir.

SUCCESS OF DEPARTMENT OF COMMERCE PROMOTIONAL ACTIVITIES

Mr. BONKER. I want to begin by commending the Department of Commerce for its promotional efforts on behalf of export trading companies. I think you have proceeded precisely as we wanted in the implementation of this act. You have not only set up the office pursuant to the act, but you made a good effort at promoting the formation of export trading companies throughout the country. I think in the first round you had something like 46 or 47 such conferences, almost all of which were well attended. In my area, I think the turnout was 400 or 500 small businesses and other interested groups. You deserve very high marks for the promotional aspects.

In addition, I haven't heard any complaints about the certification process. Here again, I think Commerce deserves high marks. My disappointment with the number of applications certainly has nothing to do with your efforts, because you have done, I think, everything conceivable to get companies interested in the concept.

Incidentally, do you still have that film?

Mr. WARNER. Yes, sir, we do.

Mr. BONKER. I think that is a marvelous film. You have chosen some good people to appear in it. [Laughter.]

Mr. WARNER. I would concur with that, Mr. Chairman. [Laughter.]

It has been widely used, most recently in the State of Washington, I understand. You might be pleased to know that a shorter version of it is being used at the Louisiana Exposition in the Commerce section down there, which we hope will be viewed by many prospective ETC operators.

Mr. BONKER. It really has been helpful in educating businessmen about these new opportunities.

CERTIFICATION PROCESS

Sixty applications have been filed and 28 have been certified.

Mr. WARNER. Yes, sir.

Mr. BONKER. What about the other 32?

Mr. WARNER. We have 13 under review at this time. The residual number would be those applications that have been returned to the applicants for certain insufficiencies. We have seen a clear elevation in the submissions here in the past probably 8 or 9 months. Early in the program, early in the review of the regs, there were a number of submissions that were just incomplete. As you know, a good part of our application involves the submission of corporate documents and things of that nature.

We have seen a tremendous improvement in the quality of submissions, and I think this is largely due to the more active participation by the Antitrust Bar and that the applicants are properly structured and well advised when they come in. Our counseling

BEST COPY AVAILABLE

services have followed up on many of the applications that on previous occasions did not make the qualification for admission.

Mr. BONKER. Say an application is in good shape, what is the average turnaround from the time it is filed at the regional office to the time it is certified?

Mr. WARNER. First, let me state, sir, that the applications come directly to the main Commerce Office of Export Trading Company Affairs, and would not normally be submitted necessarily through one of our regional offices.

Mr. BONKER. Could they get the forms at the regional office?

Mr. WARNER. Oh, yes, the forms are there. We have processed them within the 90 statutory days in each instance. We had two instances where we have completed expedited review under the statutory provisions that you know well. I would say that we are consistently within the 90 days. It is probably going to average certainly close to 90 days, 85 to 90 days, in each instance. Much of this is due to the fact that the Justice Department needs those 10 full days to concur with Commerce.

Mr. BONKER. Have there been any denials?

Mr. WARNER. No, sir, there have been no denials.

Mr. BONKER. You just returned them if they were insufficient?

Mr. WARNER. That is correct.

JUSTICE DEPARTMENT COOPERATION

Mr. BONKER. Has the Justice Department been cooperative?

Mr. WARNER. I think that, over a period of time, the concurrence processes have improved tremendously. I have to comment very favorably on the performance of my general counsel and his offices that have managed this entire process and have done an extremely competent job. I would say that, in addition to our efforts as lead Federal agency, the general counsel of Commerce is largely responsible for the smooth operation that we have today.

Mr. BONKER. No Richard Perle problems in the review process? [Laughter.]

Mr. WARNER. He has not appeared yet, Mr. Chairman. [Laughter.]

Mr. BEREUTER. Mr. Chairman, if I could interject, you didn't quite get a direct answer to your question about the Justice Department, if I could push it a little harder on that.

You talked about the assistance and the cooperation of your general counsel. You said that it is improved. But you didn't specifically answer about levels of cooperation of the Justice Department.

Mr. WARNER. I think each of the Assistant Attorneys General for Antitrust has made an effort to improve their operation. My general counsel would probably like to make a direct comment to it. But as to program management, I would say that I have recognized in the process of concurrence, the necessary difference in views and statutory issues, and we must recognize that the Justice Department is an enforcement agency and would have views that vary from ours as a promotion agency.

Irv, would you like to expand on that?

Mr. MARGULIES. The direct answer to your question is they have been very cooperative. That doesn't mean that there aren't differ-

BEST COPY AVAILABLE

ences in viewpoints; there are. Between us now, there are no big issues. We will have revised regs come out very shortly, 2 or 3 weeks, and there will be much fuller guidelines, we hope, within a very short period of time, but that is months.

There will be some issues that will have to be hammered out, however, but it is being done in a very cooperative way and we have no problem.

Mr. BEREUTER. That is good to hear.

SMALL BUSINESS PARTICIPATION

Mr. BONKER. Ms. Snowe.

Ms. SNOWE. Thank you, Mr. Chairman.

Since the inception of this legislation, what size businesses primarily benefit from it? As I remember, the debate on this issue was that the legislation was primarily touted as a tool for small- and medium-sized businesses. Can you tell us exactly who has been benefiting from it?

Mr. WARNER. I would say that the primary beneficiaries, Congresswoman Snowe, have been the small- and medium-sized business interests of the United States. As I said in my statement concerning counseling and certification processes, a number of large and multinational corporations have come in. Certainly the first certificates were all small and medium corporations. We would presume, I think, safely to see the small- and medium-sized companies, on balance, the primary submitting parties for certificates of review.

Ms. SNOWE. On the certificates, on the number that have been certified, I guess you said 28.

Mr. WARNER. Yes.

Ms. SNOWE. How does that break down in terms of size of business?

Mr. WARNER. The large businesses would number 4, the medium 5, and the small 19.

On the statement submitted, Congresswoman Snowe, on page 14, we actually have it broken down by dollar revenues, if you want that further detail.

But in answer to your question, from the applications we have received, the vast majority have been small and medium sized.

EFFECTS OF ETC LEGISLATION

Ms. SNOWE. Has there been less interest expressed—I mean, are you surprised by the small amount of interest that has been expressed in the forming export trading companies, or do you think it is a matter of time?

Mr. WARNER. The first thing I think we have to consider carefully is there are hundreds, perhaps thousands, of export trading companies in the United States operating successfully that do not have antitrust concerns. Therefore, we would only be addressing for title III certification purposes the very small minority of interests in the United States. U.S. business people are well advised by counsel and are very sensitive to antitrust issues and, I think, conduct their business affairs normally so as to avoid them. So I would see no particular change in that pattern. Of every 1,000 ETC's in the



BEST COPY AVAILABLE

United States in 1985 and beyond, I would say 4 or 5 percent at maximum would have——

Mr. BONKER. Her point is that Congress went through a lot to get this legislation passed. We had visions about companies coming forth to form ETC's. There are export management firms out there, but that wasn't the purpose of the legislation. It is not your fault, but I am a little disappointed that we haven't seen more applications before Commerce.

Mr. WARNER. Let me draw the distinction again, Mr. Chairman, if I may. That is that we only see in our counseling, in the 300 universe of counseling—I think only the small minority of companies that are coming to us are coming to us because they know or perceive they may have an antitrust question. For every one of those, there has got to be 20 or 30 or 40 in ratio that have gotten private legal advice, that what they are doing is perfectly sound, and they can go out and operate export trading companies. There is no licensing and there is no control, and we can't poll the United States.

I am suggesting that there is probably an unseen body of export trading companies which could also be export management organizations performing similar functions. They are operating very successfully, and only the Internal Revenue Service would know who they were. We wouldn't.

Ms. SNOWE. Thank you.

Mr. BONKER. Who is not coming back after the vote?

Mr. FEIGHAN. I can't, Mr. Chairman.

Mr. BONKER. OK. Why don't you go ahead.

ANTITRUST PROTECTION

Mr. FEIGHAN. Thank you, Mr. Chairman.

Mr. Warner, I was not part of the Congress that enacted this legislation in 1982. I wonder if you could explain the nature of the antitrust protection that would flow to an export trading company. Is it unlimited antitrust protection? Is it subject to review? Is it subject to reapplication?

Mr. WARNER. I am going to have the general counsel articulate that answer for you, sir. I am aware of it, but he is so very good at it, I am going to let him answer it.

Mr. BONKER. You have to do this in about 2½ minutes.

Mr. MARGULIES. It is a total immunity for the activities that are specified in the certificate as against Federal action or State action. So you are totally protected as against the Federal Government or any State government.

It is a form of protection as against a private person who thinks that he is injured by the conduct that the Federal Government certified. As to that private person, Congress determined that he still might have a lawsuit, but his lawsuit is limited to single damages. He bears the onus of overturning a presumption in favor of the correctness of Federal action and, if he is wrong on his attack, he will be stuck with the attorneys' fees for his action.

Mr. FEIGHAN. Does that protection extend for a limited period of time?

Mr. MARGULIES. The life of the certificate.

BEST COPY AVAILABLE

Mr. FEIGHAN. The certificate is issued for how long?

Mr. MARGULIES. There is no term.

Mr. FEIGHAN. So it is unlimited.

Would you recommend that we retain that temporally unlimited antitrust protection?

Mr. MARGULIES. No; we ask that it be that way. He must plan with protections in mind.

There are reporting requirements that are annual that would give us and Justice notice of changes that would require any kind of change in the certificate itself, and I see no need to assert any time limitation.

Mr. FEIGHAN. I have one final question. Has there been any problem with antitrust protection conflicting with State laws?

Mr. MARGULIES. It would preempt them. I don't see how there would be a conflict though. I don't understand the conflict question.

Mr. FEIGHAN. I realize that it would preempt them under Federal supremacy, but apparently you are not aware of any conflicts that have emerged with State law, any litigation or challenge?

Mr. MARGULIES. No.

Mr. FEIGHAN. Thank you very much.

Mr. BONKER. We will recess for approximately 10 minutes, and then we will come back and continue our hearing.

[Recess.]

Mr. BONKER. The subcommittee will reconvene. Will the witnesses take their places?

Mr. Bereuter has the time.

### CERTIFICATE OF REVIEW PROCESS

Mr. BEREUTER. Thank you, Mr. Chairman.

I have only one question. I just want to understand a little bit more about the certificate of review process. Can you give me an example or two of the type of certainty that a company is trying to nail down, a specific kind of example, and how you would proceed once you received it? I am more interested in the kind of questions of uncertainty they come to you with.

Mr. MARGULIES. Assume they wanted among themselves to allocate foreign markets. They would then specify in the certificate that conduct, that they would in fact allocate among the members of the ETC this much of market to each of them.

That then becomes an issue before us and before Justice as to whether permitting that conduct in the foreign jurisdiction in which they would sell is compatible with the standards in 303(a).

Mr. BEREUTER. Is it almost always then an allocation and the differences are simply from market to market? Is it almost always an allocation question?

Mr. MARGULIES. No, no; different certificates will raise different questions. That is one example.

Mr. BEREUTER. OK.

Mr. MARGULIES. In some cases you have horizontal activities that you are covering, and some you have vertical. The questions that will be presented to you will change because of the nature of the activity that they want to do. You can have time tying arrange-

BEST COPY AVAILABLE

ments. You can have almost any of the activities that you can think of that would be prohibited here, but are not necessarily prohibited there if there is no domestic spill-over effect. The value to the group coming to you is that they can be certain that conduct that they know they want to engage in has been looked at by those who would then have to charge misconduct and approved it.

Mr. BEREUTER. How broadly then is that information, the determination shared, and by what means?

Mr. MARGULIES. The certificate itself, the conduct that we approved is public. Let's say the world may see it. The certificate itself is on file and may be seen by anyone who wants to see it. We try to keep out of it business information that is not necessary to the certificate that would give away confidential business data.

Mr. BEREUTER. Are those decisions likely to be so specific that are not of general interest?

Mr. MARGULIES. No; I think they are of general interest, but they are specific enough so that you know what conduct you have approved under the rubric of the certificate—the film isn't protected for conduct that isn't contemplated when you come in.

Mr. BEREUTER. Is it important to share these decisions quite broadly?

Mr. MARGULIES. That is the reason that we made them public.

Mr. BEREUTER. How do you do that? Is it published in any kind of a fashion routinely?

Mr. MARGULIES. At the outset, before the certificate is rendered, there is a notice in the Register that the certificate is requested and the parameters of what is being requested. And then there is the knowledge in the regs that the certificate, when granted, will be available to the world for inspection.

Mr. BEREUTER. But a synopsis, for example, of the determination is not printed routinely in some publication—such as the Federal Register?

Mr. MARGULIES. We have done that.

Mr. BEREUTER. Would it be helpful to the business community of the country?

Mr. MARGULIES. It is worth considering, as a development device if nothing else.

We have in our speeches generally when we speak to the program discussed the items in the certificate that have been covered to give those who are listening an idea of what kind of activity they can protect.

Mr. BEREUTER. Mr. Warner.

Mr. WARNER. In answer to your question, Mr. Bereuter, Business America, a publication I am sure you are familiar with, by Commerce, has published on several occasions the principal areas of conduct that we have certified to date. Those areas of conduct we have certified are also on page 10 of the prepared testimony. They are fairly comprehensive.

Mr. BEREUTER. Thank you very much.

Thank you, Mr. Chairman.

BEST COPY AVAILABLE

INTERMEDIARY VERSUS MANUFACTURING ETC'S

Mr. BONKER. In your statement on page 7, you talk about the fact that many of the applicants have not been manufacturers of goods and products, but instead are serving as intermediaries. Can you expand on that for a moment?

Mr. WARNER. Gladly, Mr. Chairman.

As one might expect, the attraction for many of the ETC operators has been to put together a group of competitors and represent them as sole agent in many instances so that a number of facilitators that have gotten ideas about export structures——

Mr. BONKER. But the parties to this conceptual ETC, are they not manufacturers?

Mr. WARNER. Some of the parties that would be covered in the certificate would, but many of the certificate holders have merely proposed to be facilitators.

Mr. BONKER. So if I wanted to organize an export trading company for the purpose of exporting high technology medical instruments to the Pacific Rim, I could go about it one of two ways: either take the manufacturers and have them collectively form an ETC; or, as an intermediary, set up shop and in a contractual arrangement, involve the high technology producers.

Mr. WARNER. The facilitator would be, in many instances, the primary marketing vehicle. And then the manufacturers would be his suppliers and he would have agreements with them.

Mr. BONKER. Then my question is, what is the distinction between the export management company to which you referred earlier and someone who would be serving as an intermediary?

Mr. WARNER. The distinction between export management companies and many ETC operations is almost nonexistent.

Mr. BONKER. If I were going to form an ETC and involve these high technology companies, I wouldn't have to file pursuant to the provisions of title III, would I?

Mr. WARNER. Only in those instances where you either determine through counseling or by private counsel that you——

Mr. BONKER. These are close calls.

Mr. WARNER. In many instances, they can be, yes.

Mr. BONKER. If you had a filing from an ETC along the lines I have discussed, would you advise them that it is not necessary to be certified?

Mr. WARNER. We would not necessarily make that statement, Mr. Chairman. What we would probably say is that the conduct he has described for us would not appear to require certification. But we don't give him a statement to that effect because, as you can well imagine, that would reverse the integrity of the process.

Mr. BONKER. I don't see that as anything more than just an export management company.

Mr. WARNER. As I said earlier, export management companies, by definition, can easily be export trading companies. As a distinction I would say that a general trading company, ETC, is taking—as a percentage of volume—more title to goods; whereas export managers are primarily concerned with agency and representation.

Mr. BONKER. Facilitators.

Mr. WARNER. Yes, sir.

BEST COPY AVAILABLE

Mr. BONKER. We will have more questions if you can stay at the table.

Mr. WARNER. Certainly.

Mr. BONKER. Mr. Dahl, let's peer into the Federal Reserve Board and see what your experience has been with banks forming ETC's.

**STATEMENT OF FREDERICK R. DAHL, ASSOCIATE DIRECTOR, DIVISION OF BANKING SUPERVISION AND REGULATION, FEDERAL RESERVE SYSTEM**

Mr. DAHL. Thank you, Mr. Chairman.

My name is Frederick Dahl. I am an Associate Director in the Division of Banking Supervision and Regulation at the Board of Governors with responsibilities in the area of international bank regulatory policy.

I am just going to touch on the highlights of my statement today, Mr. Chairman, and ask that the complete statement and attachments be included in the record.

Mr. BONKER. Thank you. Without objection, your statement will be printed in full in the official record.

FEDERAL RESERVE BOARD ROLE

Mr. DAHL. Thank you.

I appreciate the opportunity to appear before this subcommittee on behalf of the Board of Governors to discuss the role of the Reserve Board in implementing the Bank Export Services Act. That act, as you know, authorizes bank holding companies to acquire equity interests in export trading companies and empowers the Federal Reserve Board to act on proposals to do so.

However, the act envisages a fairly restrictive role for the Reserve Board in relation to those investments in export trading companies. First of all, it provides for a notification procedure rather than a prior approval procedure for an investment by a bank holding company in an export trading company. The investments can be made, unless specifically disapproved by the Board, within, at most, 90 days after the notice is accepted.

Second, the legislation establishes limited grounds on which the Board may object to a proposed investment. The Board may disapprove a proposed investment only if it determines that disapproval is necessary to prevent unsafe and unsound banking practices, undue concentration of resources, decreased or unfair competition, or conflicts; or if the Board finds that the investment would affect the financial and managerial resources of a bank holding company to an extent that is likely to have a materially adverse effect on the safety and soundness of a subsidiary bank.

Another basis for disapproval is when the bank holding company fails to furnish sufficient information about the proposal, as required by the regulation.

The Board's regulations to implement this legislation, which were promulgated in June 1983, are brief. Their principal purpose is to clarify what appear to be some ambiguities in the statutory language. The regulations are concerned with definitions, rules governing investments and extensions of credit, and on notices to invest in export trading companies and their processing.

BEST COPY AVAILABLE

FEDERAL RESERVE BOARD DEFINITION OF AN ETC

In adopting regulations, there were three principal issues faced by the Board. The first one was the definition of an export trading company in which a bank holding company might invest. Here the problem was that the statutory language could be interpreted in such a way as to permit a bank holding company to invest in any company that principally provides its own services to nonresidents. One example under that interpretation would be that it would permit a general insurance underwriting company to qualify so long as all the customers were non-U.S. residents. A number of people argued for such an interpretation.

The Board, however, read the legislative history of the act to support a narrower interpretation, namely that the export trading company should serve principally as an intermediary for U.S. producers and suppliers of goods and services in the foreign marketing and sale of their products.

Another aspect of the definition of an export trading company centered on the statutory requirement that that company should be principally engaged in exporting. The Board concluded that a test that would be liberal yet, at the same time, consistent with the congressional purpose of promoting exports and not simply trade, would be a 50-percent test. That is, at least half of the revenues of the affiliated export trading company, as measured over a 2-year period, would have to be derived from exporting or facilitating the exportation of goods and services from the United States.

COLLATERAL REQUIREMENTS AND ETC'S

A third issue related to the collateral restrictions of section 23(A) of the Federal Reserve Act and whether they should apply to transactions between the export trading company and the affiliated bank of the bank holding company. Broadly speaking, under section 23(A), credit transactions between a bank and its parent bank holding company and its nonbank subsidiaries are restricted in amount and must be supported by marketable collateral.

With respect to export trading companies, the question arose because the Bank Export Services Act has provisions stating that no provision of Federal law in effect on October 1, 1982, relating to collateral requirements——

Mr. BONKER. Did that come after the enactment of ETC legislation?

Mr. DAHL. No, it didn't. The new Garn-St Germain version of section 23(A) is——

Mr. BONKER. Came after.

Mr. DAHL. It was enacted 2 weeks later, October 15. That is where some of the confusion arose, I believe, that the exact language of BESA refers to what was in effect on October 1, and the Garn-St Germain Depository Institutions Act on October 15 revised section 23(A) in its entirety and established an entirely new set of collateral requirements for affiliated lending.

Some of the commenters on the Board's proposed regulations——

Mr. BONKER. Excuse me. Did that second piece of legislation attempt to amend the Export Trading Company Act, or was it a broader policy that covered the earlier provisions?

BEST COPY AVAILABLE

Mr. DAHL. No; it was the latter. It was a complete revision of section 23(A) which had been in process for a considerable period of time.

Mr. BONKER. But it had the effect of——

Mr. DAHL. It still applied to all affiliates of bank holding companies and their subsidiary banks.

Mr. BONKER. Yes.

Mr. DAHL. And there were no exceptions made for the export trading company.

Mr. BONKER. I see.

Mr. DAHL. So, in those circumstances, the Board concluded that these restrictions on loans and extensions of credit by the bank to an affiliated export trading company should apply.

On the other hand, in the final regulations, in order to allow an export trading company to obtain normal trade financing from an affiliated bank, the regulations included a waiver of the collateral requirements where the bank provides a letter of credit for the account of its affiliated export trading company or advances funds for the purchase of goods for the resale of which the export trading company has a firm order and where the bank has a security interest in the goods equal to the value of the letter of credit advance. And the Board indicated at that time that it might be prepared to grant additional waivers based on specific requests. The new version of section 23(A) gave the Board power to grant waivers in special circumstances.

FEDERAL RESERVE BOARD APPROVALS

Procedurally, the initial notifications to invest in export trading companies were all acted on by the Board. By December 1983, however, the Board concluded that these could be acted upon by the Reserve Banks under delegated authority in many instances which could expedite the processing. The criteria for processing notifications under delegated authority are listed on page 4 of my statement.

As of this time, the Federal Reserve has acted upon 26 notifications involving 28 bank holding companies. The Board has not objected to any of these notifications. The Board has acted on all but one of those notifications, I believe, within the 60-day period, and has only extended it to 90 days in one instance.

Of the 28 bank holding companies that have filed notices, 9 are multinational banking organizations, 5 others have assets over $5 billion, 7 have assets between $1 billion and $5 billion, 6 have assets of less than $600 million, and 1 is a foreign banking organization. In other words, they range right across the spectrum of banking institutions in the United States.

For the most part, the proposals have involved the formation of entirely new companies as wholly owned subsidiaries of the bank holding company. There have been some exceptions, however. Several have involved investments in going concerns primarily to obtain the services of people in the companies. These companies have been small, however. There have also been proposals involving joint ventures, the most notable of which is the partnership involving First Chicago Corporation and Sears World Trade. Another

BEST COPY AVAILABLE

one is a de novo export trading company established by three relatively small bank holding companies in New Jersey.

Mr. BONKER. Is that pursuant to the bankers' bank provision?

Mr. DAHL. Pardon me, sir?

Mr. BONKER. We had a provision that would allow smaller banks to set up an ETC collectively. I think they were called bankers' banks.

Mr. DAHL. No; this isn't bankers' banks. These are regular bank holding companies, but they are smaller and they combine forces in a sense. There was a general indication in the provisions of the act and its legislative history that would encourage joint ventures among institutions to promote export trading companies. In this case, it happened to be three bank holding companies; whereas the other one involving Sears and First Chicago involves two very large organizations.

Mr. BONKER. There are bank holding companies, but also smaller banks called a bankers' banks, which are banks whose only clients are other banks. Small banks form bankers' banks to offer a variety of services they could not offer independently. Obviously, you have not had much experience with bankers' banks.

Mr. DAHL. No; bankers' banks are a fairly new development in the country, and they tend, I think, to feature operational services to banks as opposed to dealing with the public.

Mr. BONKER. But they would have to apply for a certification.

Mr. DAHL. No. No.

Mr. BONKER. I see heads behind you. Some are going this way, and some are going this way. But you are at the witness table, so you have the final word. [Laughter.]

You may proceed.

Mr. DAHL. One can separate the proposals that the Board has reviewed in two broad groups: First where they are primarily either financing or trade-service producing, services including things like freight-forwarding, market research, some product research and consulting and other types of market advisory services; and the second are those composed of companies who expected to engage in trade transactions as well. While those in the latter group expected to take title to goods, as a whole, they planned to do so only against firm orders. None said that they would attempt to maintain an inventory of goods and then go out and try to find a buyer for them.

### ETC CONCEPT STILL NEW

As to the experience to date, I am afraid not too much can be said about it, primarily for the reason that very little time has elapsed. The Board acted on the first proposal for an export trading company—a bank holding company—only a little over a year ago, and over one-third of the proposals that have been made date only from the beginning of this year. It is not surprising that most of the companies are still in what you might call the formative stage, still getting organized and looking for personnel, and trying to identify markets and potential customers. And the companies where operations have in fact commenced, it is not yet clear which

BEST COPY AVAILABLE

direction they will take in either size or character. Only a few have done trade transactions.

The impression one gets from discussions with people in the companies is that they are continuing to explore and experiment and that this will be their main characteristics for some time to come. In short, it appears to us that it is still early days to evaluate the success of this legislation and determine whether the present rules are adequate.

In conclusion, I just might say that, under the statute, the Board is required to make a formal report to the Senate and House Banking Committees at the beginning of October this year, and to include any recommendations and changes in that legislation. So that formal review will be taking place in the early fall.

That completes my statement, Mr. Chairman.

[Mr. Dahl's prepared statement follows:]

BEST COPY AVAILABLE

PREPARED STATEMENT OF FREDERICK R. DAHL, ASSOCIATE DIRECTOR, DIVISION OF BANKING SUPERVISION AND REGULATION, BOARD OF GOVERNORS OF THE FEDERAL RESERVE SYSTEM

I appreciate the opportunity to appear before this Subcommittee on behalf of the Board of Governors to discuss the role of the Federal Reserve in implementing the Bank Export Services Act. The Bank Export Services Act, which is Title II of the Export Trading Company Act of 1982, authorizes bank holding companies to acquire equity interests in export trading companies and empowers the Federal Reserve Board to act on proposals to do so. It is my intent today to give a brief overview of the regulations adopted by the Board to implement the legislation and to summarize the holding company proposals acted upon by the Board to date. This is followed by a description of the current activities of the export trading companies owned by bank holding companies.

The Bank Export Services Act envisages a fairly restrictive role for the Federal Reserve in relation to investments by bank holding companies in export trading companies. First, it establishes a notification procedure, as opposed to a prior approval procedure, for such investments. The investments can be made, unless specifically disapproved by the Board, within, at most, 90 days after the notice is accepted. Second, the legislation establishes quite limited grounds on which the Board may object to a proposed investment. The Board may disapprove a proposed investment only if the Board determines disapproval is necessary to prevent unsafe and unsound banking practices, undue concentration of resources, decreased or unfair competition, or conflicts of interest; or if the Board finds that the investment would affect the financial and managerial resources of a bank holding company to an extent that is likely to have a materially adverse effect on the safety and soundness of a subsidiary bank. The only other basis for disapproving an investment is that the bank holding company fails to furnish information about the proposal that is required by regulation.

BEST COPY AVAILABLE

The Board's Regulations

The Board's regulations implementing the Bank Export Services Act are brief. Their principal purpose is to clarify a few areas of ambiguity in the statutory language. For the most part, these clarifications reflect an attempt to limit the potential for conflicts of interest that might grow out of bank affiliation with an export trading company. The final regulations were promulgated on June 2, 1983. A copy of the regulations is attached as Appendix A.

In adopting final regulations, there were three principal issues. The first was the definition of an export trading company in which a bank holding company may invest. The problem was that the statutory language could be interpreted to permit a bank holding company to invest in any company that principally provides its own services to non-U.S. residents. For example, the statute might be read to permit a general insurance underwriting company to qualify as an export trading company that could be owned by a bank holding company as long as the customers were non-U.S. residents. A number of commenters on the proposed regulations argued for such an interpretation. The Board, however, read the legislative history of the Bank Export Services Act to support a narrower interpretation -- namely, that the export trading company should serve principally as an intermediary for producers and suppliers of goods and services in the foreign marketing and sale of their products by providing a range of export trade services.

Another aspect of the definition of an export trading company centered on the statutory requirement that a bank holding company-controlled export trading company should be "principally engaged in exporting." The Board determined that a test that would be liberal, yet at the same time consistent with the Congressional purpose of promoting exports, and not

BEST COPY AVAILABLE

simply trade, would be a 50 percent test: at least half of the revenues of a bank holding company-affiliated export trading company, as measured over a two-year period, must be derived from exporting, or facilitating the exportation of, goods and services. In this regard, revenues derived from trade between third countries (two countries other than the United States) and countertrade (an export from a third country undertaken as a quid pro quo for allowing U.S. goods to be imported into that country) are counted as non-export revenues for the purposes of this test. Again, the rationale for this determination was that the Bank Export Services Act was export legislation, not trade legislation. Furthermore, these types of transactions might result in providing substitutes for the export of U.S. goods.

The third issue was whether the collateral restrictions of Section 23A of the Federal Reserve Act (12 U.S.C. § 371c) should apply to transactions between the export trading company and the affiliated bank of the bank holding company. Broadly speaking, credit transactions between a bank and its parent bank holding company and its nonbank subsidiaries are restricted in amount and must be supported by marketable collateral. The question arose with respect to export trading companies because the Bank Export Services Act has a provision stating that no provision of federal law in effect on October 1, 1982, relating to collateral requirements shall apply with respect to extensions of credit from the subsidiaries of a bank holding company to its affiliated export trading company. On October 15, 1982, however, the Garn-St Germain Depository Institutions Act of 1982 revised Section 23A in its entirety and established new collateral requirements for affiliate lending. While some commenters on the Board's proposed regulations argued that these new collateral provisions should not apply to export trading companies, the Board determined, on the basis of the statutory language and its understanding of the legislative

BEST COPY AVAILABLE

history, to apply the restrictions to loans and extensions of credit by a bank to its affiliated export trading company. On the other hand, in order to allow an export trading company to obtain normal trade financing from an affiliated bank, the regulations include a waiver of the collateral requirements where the bank provides a letter of credit for the account of its affiliated export trading company, or advances funds for the purchase of goods for the resale of which the export trading company has a firm order, and where the bank has a security interest in the goods, or proceeds from the sale of the goods, equal to the value of the letter of credit or advance. Furthermore, the Board indicated that it might grant additional waivers based on specific requests.

The initial notifications to invest in export trading companies were all acted on by the Board. In December 1983, however, on the basis of experience up to that time, the Board concluded that export trading company notifications could be acted upon by the Reserve Banks under delegated authority, which could expedite the processing. The criteria for processing notifications under delegated authority are: (1) the proposed export trading company is to be a wholly-owned subsidiary, or ownership is to be shared only with individuals involved in the operation of the export trading company; (2) the bank holding company investor and its lead bank meet the minimum capital adequacy guidelines of the Board and the Comptroller of the Currency or have capital enhancement plans acceptable to the appropriate supervisory authority; (3) the proposed export trading company will take title to goods only against firm orders, except that the company may maintain an inventory of goods of up to $2 million; (4) the proposed activities of the company do not include product research or design, and product modification; and (5) the proposed leveraging of the export trading company (assets: capital) does not exceed 10:1.

BEST COPY AVAILABLE

Notifications Acted Upon to Date

As of this time, the Federal Reserve System has acted upon 26 notifications, involving 28 bank holding companies, to establish export trading companies. The Board has not objected to any of these notifications. A list of the bank holding companies that have authority to establish an export trading company is contained in Appendix B.

Of the 28 bank holding companies that have filed notices to date, nine are multinational banking organizations, five others have assets over $5 billion, seven have assets between $1 and $5 billion, six have assets of less than $600 million, and one is a foreign banking organization.

For the most part, these proposals have involved the de novo formation of an export trading company as a wholly-owned subsidiary of the bank holding company. There have been a few exceptions to this, however. Several proposals have involved investments in going concerns where the attraction has been primarily the skills and expertise of the people in the companies. These companies have been small. There have also been proposals involving joint ventures. The most notable of these is a partnership involving First Chicago Corporation and Sears World Trade. Another instance is an export trading company owned by three relatively small New Jersey bank holding companies.

The proposals reviewed by the Board can be separated into two broad groups. The first consists of those where the export trading company was conceived as furnishing primarily financing and export trade services. These services include market research, product research, freight forwarding, consulting, and advisory services. The second group is composed of those companies that were expected to engage in trade transactions as well. Although this would involve taking take title to goods, these companies planned to do so only against firm orders. No bank holding company said that it would try

BEST COPY AVAILABLE

to make an overseas market for goods that they had bought and were holding in inventory pending discovery of a buyer.

Turning to the experience of bank-affiliated export trading companies, it has to be said at the outset that the first proposal by a bank holding company to establish one was acted on by the Board in May 1983, only a little over a year ago. Over one-third of the proposals actually only date from the beginning of this year. Thus, it is not surprising that most of them are still in the formative stage -- getting organized, looking for personnel, identifying markets and potential customers, and the like. In those companies where operations have commenced, there are no clear indications of how their operations will develop in either size or character. Only a few have done trade transactions, and those transactions have generally been quite small. Discussions with these institutions from time to time suggest that exploration and experimentation will be the prime characteristics of many for some time to come. In short, it appears far too early to evaluate the success of the legislation and to determine whether the present rules contain impediments to the effective operation of these companies.

Later this year, the Board will be reviewing the progress of export trading companies affiliated with bank holding companies. That review is prompted by the requirement in the Bank Export Services Act that the Board make a report to the Senate and House Banking Committees on or before October 2, 1984, on the implementation of the Bank Export Services Act and on any changes in the legislation.

BEST COPY AVAILABLE

Appendix A

FEDERAL RESERVE SYSTEM

REGULATION K
[12 C.F.R. Part 211]
[DOCKET NO. R-0445]

INTERNATIONAL BANKING OPERATIONS
Export Trading Companies

AGENCY: Board of Governors of the Federal Reserve System.

ACTION: Final rule.

SUMMARY: The Bank Export Services Act (Pub.L. 97-290, Title II (1982)) amended the Bank Holding Company Act of 1956 to permit bank holding companies, their subsidiary Edge or Agreement corporations, and bankers' banks to invest in export trading companies. The regulation implements and interprets this provision by establishing procedures for prior Board review of these investments and providing guidance on how the Board intends to administer the statute.

EFFECTIVE DATE: 30 days from date of publication.

FOR FURTHER INFORMATION CONTACT: Nancy Jacklin, Assistant General Counsel (202/452-3428), or Kathleen O'Day, Senior Attorney (202/452-3786), Legal Division; or Frederick R. Dahl, Associate Director (202/452-2726), or James Keller, Manager, International Banking Applications (202/452-2523), Division of Banking Supervision and Regulation, Board of Governors of the Federal Reserve System.

SUPPLEMENTARY INFORMATION: On October 8, 1982, the Export Trading Company Act of 1982 ("ETC Act") was enacted into law. The purpose of the statute is to encourage U.S. exports by facilitating the formation and operation of export trading companies and the expansion of export trade services generally. Title II of the ETC Act, known as the Bank Export Services Act ("BESA"), amends section 4 of the Bank Holding Company Act ("BHC Act") to permit bank holding companies to invest in export trading companies subject to certain limitations and after prior Board review. The Board's regulations, which were published for public comment on January 17, 1983, were framed to achieve two objectives set forth in the BESA: to facilitate the export of goods and services produced in the United States by allowing for meaningful and effective participation of bank holding companies in the financing and development of export trading companies, and to help avoid adverse effects on the subsidiary banks of the bank holding companies involved.

The Board received 23 public comments on the proposed regulations as well as comments from 10 Reserve Banks. The

BEST COPY AVAILABLE

commenters focussed primarily on the following issues: the definition of an export trading company, the application of preferential lending restrictions, the applicability of the collateral requirements of section 23A of the Federal Reserve Act to extensions of credit by a bank to an affiliated export trading company, and the establishment of general consent procedures. In light of the comments received, the Board has adopted several revisions in the draft regulations.

Definition of export trading company

In the comments received on the draft regulations, several commenters took the view that the definition of "export trading company" in the draft regulations improperly limited the range of activities that are permissible under the BESA. This definition was included in the draft regulations to clarify ambiguities in the language of the BESA and to further Congressional intent. The issue raised is whether Congress intended through the BESA to authorize banking organizations only to invest in a company that provides services to facilitate trade in goods and services produced by others, or whether Congress intended to grant the much broader authority to invest in any service company that principally provides its own services to non-residents. That is, is any company that is a service company but which deals with foreign residents to be considered an "export trading company"? Such an interpretation of the statute has potentially broad implications for the separation of banking and commerce, substantially increasing the activities in which a bank holding company can engage both in the United States and abroad.

The language and purposes of the BESA, and its legislative history as a whole, provide sufficient support for the interpretation reflected in the definition of "export trading company" contained in the regulations. Throughout the hearings and subsequent Congressional actions on the export trading company legislation, there is no evidence of Congressional consideration of the significant question whether bank holding company investment was needed in U.S. service industries in order to develop those industries for an export market. Rather, the common thread throughout consideration of the legislation is that banking organization investment was thought to be needed in what are commonly regarded as export trading companies -- companies that serve as intermediaries for producers and suppliers of goods and services in the foreign marketing and sale of their products by providing a range of export trade services. Banking organization involvement was considered particularly helpful in that the overseas networks of many such organizations could provide a basic existing infrastructure for carrying out that intermediation role.

BEST COPY AVAILABLE

Thus, the services that may be provided by an export trading company under the regulations are those types of services listed in the definition of "export trade services" in the statute, where the services are provided in connection with trade in goods and services produced by others. Consistent with the regulation the export trading company could, inter alia, provide transportation insurance, or product liability insurance abroad, for goods in international trade; travel insurance related to international transportation services provided by others; consulting services promoting or facilitating trade transactions; marketing goods or services produced by others, including brokering insurance on risks located abroad; and warehousing services for products in international trade.

The Board finds that the definition of "export trading company" contained in the regulation is consistent with the purposes of the Act and does not hinder the effective operation of export trading companies in which bank holding companies may invest. The alternative statutory interpretation favored by some of the commenters does not appear to be consistent with Congressional intent and would authorize bank holding company investments in business concerns never contemplated by the Congress in its consideration of the legislation. Accordingly, the Board retained in the final regulations the definition of "export trading company" as it appeared in the draft regulations.

Under the definition of "export trading company" in the regulations, an export trading company would be able to engage, in addition to its primary business of exporting, in activities related to importing, third party and barter trade up to half of its business. In determining whether goods are produced in the United States, reference may be made to the definitions used in preparing the Shipper's Export Declaration (a Department of Commerce form) for domestic merchandise exports from the United States. In determining whether services are "produced in the United States," for purposes of the BESA, reference may be made generally to the concepts applied by the Department of Commerce in compiling the U.S. balance of payments accounts as to services exports, following the general rule that services performed by U.S. residents for non-U.S. residents would be considered covered by the term. "United States" for this purpose has the same meaning as that in Section 103(a)(6) of the Export Trading Company Act (15 U.S.C. § 4002).

A number of the comments focussed on aspects of the requirement that "more than half" of the export trading company's annual revenues must be derived from exports or facilitating exports. Some considered the test too high. One commenter considered the required percentage of export activity contained in the draft regulations to be too low. In addition,

BEST COPY AVAILABLE

many commenters recommended that the percentage of export-related revenues be assessed over a period of time longer than the one-year period originally provided for in the regulation.

The Board believes that the test that more than half an export trading company's revenues should be export-related is consistent with the purposes of the BESA, and is not so rigid as to make profitable operation of an export trading company impracticable. However, in order to allow for increased flexibility for an export trading company to adapt to unforeseen changes in market conditions, the Board decided to liberalize the time period for meeting the test. The regulation adopted provides that an export trading company must meet the test on a biannual rather than on an annual basis. The biannual test will be measured by consecutive two-year periods rather than by a two-year moving average. The Board expects that where the requirement is not met, the export trading company will indicate the reasons for noncompliance and develop and implement an adequate plan for meeting the requirement.

The definition of "revenues" was also the subject of some discussion by the commenters. The draft regulations defined revenues as gross revenues of the export trading company. The Board is in agreement with those comments that pointed out that use of "gross revenues" as the measurement for qualification of an export trading company could have unintended and somewhat arbitrary results, depending upon the activities of a particular export trading company. For example, the revenues generated by an export trading company's buying and selling of goods on a "gross revenues" basis would necessarily have a much greater weight in determining whether an export trading company meets the "principally" test than revenues generated by that export trading company's provision of services on a fee basis. For example, a company that primarily facilitates imports but also does some exporting nonetheless could qualify as an export trading company. The converse also would be true. Consequently, the Board decided that "revenues" should be defined in the regulations to include net sales revenues from the trading of goods by the export trading company for its own account (i.e., the gross revenues received from the sale of goods less the expenditures made for the goods), and gross revenues derived from all other activities of the export trading company.

Another question that arose regarding the revenues test was how to treat revenues from third party trade or from countertrade. Some of the comments recommended that third party trade revenues not be included in the calculation of an export trading company's revenues for purposes of determining whether more than half the export trading company's business is U.S. export-related, nor that revenues from U.S. imports or

BEST COPY AVAILABLE

third party trade in a countertrade transaction be so counted. The first proposal was based on the reasoning that third party trade should not be limited in the same manner that import activities are limited because they do not "reduce" demand for U.S. products in the same way. However, this could mean that an "export trading company" could be a company principally engaged in third party trade, which clearly is not the intent of the BESA. The argument was made, as to countertrade, that the importing or third party transaction may be the only way that a U.S. product can be exported and so the revenues derived from the importing or third party trade component of countertrade transactions should not be counted in the revenues test. However, Congress appears to have intended that these activities should be conducted where necessary or useful in the conduct of an export trading company's primary business of exporting, so that the revenues generated by the non-exporting activities should not exceed the export trading company's export revenues. Therefore, the Board adopted no changes in the regulation on these points.

Investments and Extensions of Credit

A. Limits on Amounts

The BESA authorizes banking organizations, as described above, to invest in export trading companies subject to certain prudential limits on aggregate financial exposure of each organization in this new activity. The regulations include the statutory limitations on investment, i.e., a bank holding company, Edge or agreement corporation or bankers' bank may invest a total of five per cent of its consolidated capital and surplus in export trading companies. An Edge or Agreement corporation not engaged in banking (i.e., deposit-taking in the United States from unaffiliated persons) may invest a total of up to 25 per cent of its consolidated capital and surplus in export trading companies. Reinvested dividends by the investor and retained earnings of the export trading company are not considered an "investment" in determining compliance with the investment limitation.

The legislation also contains certain restrictions on extensions of credit by banking organizations to affiliated export trading companies and their customers. The draft regulation limited the amount of credit that an investor could extend, directly or indirectly, to its affiliated export trading company or export trading companies to 10 per cent of the investor's consolidated capital and surplus. This provision elicited several comments, most of which objected to applying the 10 per cent credit limit on an aggregate basis to loans to all export trading companies in which a bank holding company invests. The Board believes that aggregate extensions of credit to all export trading companies in which the bank holding company invests is the only reasonable interpretation of this provision. The contrary interpretation would make this

BEST COPY AVAILABLE

prudential limit meaningless since a bank holding company could easily choose to conduct its export trading company activities through an unlimited number of small, e.g., single service, companies and effectively avoid the statutory limitation. This limitation does not appear to pose any immediate problems. In any event, the Board must report to Congress by October 8, 1984, on its experience under the BESA. Should it develop that banking organization involvement in export trading companies may be unduly hampered by such a lending limitation, the Board will consider making appropriate recommendations for modifications in the legislation.

B. Section 23A of the Federal Reserve Act ("FRA")

A major area of comment involving extensions of credit was the applicability of the collateral requirements of section 23A of the FRA to covered transactions between a bank holding company's subsidiary bank and an affiliated export trading company. Most of the comments received from the industry recommend that the Board exempt all bank extensions of credit to an export trading company affiliate from section 23A's collateral requirements. Some of the reasons given for this position are: that it is virtually impossible to colleteralize the financing of export services; that in the start-up phase an export trading company would probably not have the capital against which to borrow; and that the export trading companies of small or regional bank holding companies with limited access to financing in the commercial paper market would be competitively disadvantaged.

On May 9, the Board acted on the first notification by a bank holding company under the BESA in which the bank holding company requested a waiver in certain circumstances from the collateral requirements of section 23A. The Board waived the section 23A collateral requirements in the following transactions: where the bank provides a letter of credit for the account of its affiliated export trading company or advances funds for the purchase of goods for the resale of which the export trading company has a firm order from a bona fide customer, and where the bank has a security interest in the goods or proceeds from the sale of the goods at least equal in value to the letter of credit or advance. The Board concluded that, with this waiver, the export trading company could finance, through its affiliated bank, the purchase of goods in which it is trading without creating an undue risk to the bank.

The Board believes that the granting of the limited waiver should address many of the concerns raised in the public comments on the section 23A issue. With such a waiver, the major export trading company activities requiring substantial

BEST COPY AVAILABLE

amounts of financing could in fact be financed by the affiliated bank, and this method could be used by large or small bank holding companies alike. The Board accordingly adopted a regulation incorporating this type of waiver. The Board may grant additional waivers from the section 23A collateral requirements based on specific requests.

C. Preferential Lending

In addition to limiting the financial risk to affiliated banks by limiting the investor's financial exposure in export trading companies, the legislation contains a further provision specifically intended to mitigate potential conflicts of interests and associated risks where a banking organization is linked with a commercial venture. A bank holding company or its subsidiary may extend credit to an affiliated export trading company or its customers on terms no more favorable than those afforded similar borrowers in similar circumstances. The proposed regulation provided that the term "customer" includes affiliates of the customer in order to prevent potential evasions of the purpose of this statutory provision.

The proposed regulation also applied the foregoing limitation on preferential lending to extensions of credit by a bank holding company to a co-investor with at least a 10 per cent interest in an export trading company or to affiliates of the co-investor. The Board is concerned that joint ventures, particularly between banking and nonbanking organizations, create a serious potential for conflicts of interest and concentration of economic resources. However, the Board recognizes that the legislation specifically authorizes joint ventures both between banking organizations and between banking and nonbanking organizations. The limitations contained in the regulations on preferential lending, which are designed to reduce potential conflicts of interest and unsound banking practices that might result from joint venture export trading companies, do not in any way affect the ability of the bank holding company or its affiliated banks to offer to the export trading company, its customers, or a co-investor any rate that is based on the established creditworthiness of the borrower. Rather, the provision merely incorporates principles of sound banking practice.

The Reserve Banks' comments express the view that since all preferential lending is undesirable, the prohibition should apply to all transactions and the reference to a 10 per cent minimum interest of a co-investor should be deleted. Although the Board agrees that all preferential lending is undesirable, the Board nonetheless believes that a 10 per cent minimum interest in an export trading company is a reasonable threshhold for closer scrutiny of transactions and the regulatory requirement need not be changed.

BEST COPY AVAILABLE

Several commenters considered the preferential lending restrictions as inordinately burdensome from an administrative standpoint. In light of these comments, the Board determined that affiliates of an export trading company's customers need not be included in the preferential lending prohibition in the regulation. Of course, if it were to become apparent that the prohibition on preferential lending was being evaded through loans to an affiliate of an export trading company's customer, appropriate enforcement action could be taken at that time.

In response to one comment concerning possible problems with extraterritorial application of the regulations where a foreign banking organization subject to the BESA invests in an export trading company, the Board notes that the preferential lending restrictions apply only to U.S. activities of foreign banks.

Notification Procedures

Commenters suggested various criteria as a basis for allowing general consent procedures. The Reserve Banks generally were opposed to adoption of general consent procedures at this time. The Board concluded that on balance the establishment of such procedures would be premature until more experience with bank involvement in export trading companies is obtained, and the Board intends to reconsider this issue after some reasonable experience has been gained in the export trading company notification process, no later than one year from the effective date of these regulations.

The Board has deleted the reference in the regulations to the information required in notifications under the BESA. In considering the pending and completed notices to date, identification of activities by Standard Industrial Classification has been found to be unnecessary. Further, the use of the Subpart A, Regulation K checklist for Proposed Investments (Attachment E to Board Form F.R. K-1) has been a suitable vehicle for obtaining needed information. The Board also deleted the activity "freight forwarding" from the list of activities for which a subsequent notification to the Board is required if the activity was not included in the bank holding company investor's original notice. Upon closer review of the activity, it was determined that the potential risks associated with that activity should not necessitate the subsequent notice requirement.

Finally, a significant issue in connection with notifications of proposed investments in export trading companies was presented to the Board with the proposed regulations. It was noted that the proposed leveraging

BEST COPY AVAILABLE

ratios of export trading companies should be carefully examined in connection with notifications and in subsequent supervision of the bank holding companies. This is especially true where the company is engaged in trading and where the bank holding company's investment in the export trading company is significant. Capital adequacy is a critical determinant of financial strength of the export trading company and its ability to withstand unexpected adverse developments so as not to affect the financial resources of the parent holding company or the safety and soundness of affiliated banks. Capital adequacy of the export trading company also serves to assure competitive equality of bank-affiliated companies with companies that do not have the benefit of bank affiliation. Accordingly, the Board will consider the capital adequacy of an export trading company as an important factor to be taken into account in determining whether to disapprove a proposed bank holding company investment. The Board will consider adopting industry-wide capital standards generally for bank-affiliated export trading companies based on the Board's further experience with specific notifications of proposed investments (e.g., after considering approximately a dozen such notices but no later than one year after adoption of these regulations). In the interim, banking organizations considering investments in export trading companies will be able to obtain guidance regarding the Board's policies on capital adequacy for export trading companies in the context of Board actions on individual notices.

Bank holding company investment in export trading companies also raises the need to review the adequacy of the capital of the parent organization. Where a bank holding company seeks to expand its activities and operations through an export trading company, the Board will, in evaluating the proposed investment, also address the capital adequacy of the holding company.

The foregoing discussion constitutes the analysis required by the Regulatory Flexibility Act (5 U.S.C. 604).

BEST COPY AVAILABLE

List of subjects in 12 C.F.R. Part 211

Banks, banking; Federal Reserve System; foreign banking; investments; reporting requirements.

Pursuant to its authority under section 5 of the Bank Holding Company Act (12 U.S.C. § 1844), the Board proposes to amend 12 C.F.R. Part 211 by adding a new Subpart C, reading as follows:

PART 211
INTERNATIONAL BANKING OPERATIONS

Subpart A * * *

Subpart B * * *

Subpart C - Export Trading Companies

Sec.
211.31 Authority, purpose and scope

211.32 Definitions

211.33 Investments and extensions of credit

211.34 Procedures for filing and processing notices

AUTHORITY: Federal Reserve Act (12 U.S.C. § 221 et seq.); Bank Holding Company Act of 1956, as amended (12 U.S.C. § 1841, et seq.); the International Banking Act of 1978 (Pub. L. 95-369; 92 Stat. 607; 12 U.S.C. § 3101 et seq.); and the Bank Export Services Act (Title II, Pub. L. 97-290, 96 Stat. 1235 (1982)).

* * *

Subpart C - Export Trading Companies

SECTION 211.31 - AUTHORITY, PURPOSE AND SCOPE

(a) Authority. This Subpart is issued by the Board of Governors of the Federal Reserve System ("Board") under the authority of the Bank Holding Company Act of 1956, as amended (12 U.S.C. § 1841 et seq.) ("BHC Act"), and the Bank Export Services Act (Title II, Pub. L. 97-290, 96 Stat. 1235 (1982)) ("BESA").

(b) Purpose and Scope. This Subpart is in furtherance of the purposes of the BHC Act and the BESA, the latter statute being designed to increase U.S. exports by

BEST COPY AVAILABLE

encouraging investments and participation in export trading companies by bank holding companies and the specified investors. The provisions of this Subpart apply to: (1) bank holding companies as defined in section 2 of the BHC Act (12 U.S.C. § 1841(a)); (2) Edge and Agreement corporations, as described in section 211.1(b) of this Part, that are subsidiaries of bank holding companies but are not subsidiaries of banks; (3) bankers' banks as described in section 4(c)(14)(F)(iii) of the BHC Act (12 U.S.C. § 1843(c)(14)(F)(iii)); and (4) foreign banking organizations as defined in section 211.23(a)(2) of this Part. These entities are hereinafter referred to as "eligible investors."

SECTION 211.32 - DEFINITIONS

The definitions of section 211.2 in Subpart A apply to this Subpart subject to the following:

(a) "Export trading company" means a company that is exclusively engaged in activities related to international trade and, by engaging in one or more export trade services, derives more than one-half its revenues in each consecutive two-year period from the export of, or from facilitating the export of, goods and services produced in the United States by persons other than the export trading company or its subsidiaries. For purposes of this subsection, revenues shall include net sales revenues from exporting, importing, or third party trade in goods by the export trading company for its own account and gross revenues derived from all other activities of the export trading company.

(b) The terms "bank," "company" and "subsidiary" have the same meanings as those contained in section 2 of the BHC Act (12 U.S.C. § 1841).

SECTION 211.33 - INVESTMENTS AND EXTENSIONS OF CREDIT

(a) Amount of Investments. In accordance with the procedures of section 211.34 of this Subpart, an eligible investor may invest no more than five per cent of its consolidated capital and surplus in one or more export trading companies, except that an Edge or Agreement corporation not engaged in banking may invest as much as 25 per cent of its consolidated capital and surplus but no more than five per cent of the consolidated capital and surplus of its parent bank holding company.

(b) Extensions of credit.

(1) Amount. An eligible investor in an export trading company or companies may extend credit directly or

BEST COPY AVAILABLE

indirectly to the export trading company or companies in a total amount that at no time exceeds 10 per cent of the investor's consolidated capital and surplus.

(2) Terms. An eligible investor in an export trading company may not extend credit directly or indirectly to the export trading company or any of its customers or to any other investor holding 10 per cent or more of the shares of the export trading company on terms more favorable than those afforded similar borrowers in similar circumstances, and such extensions of credit shall not involve more than the normal risk of repayment or present other unfavorable features. For the purposes of this provision, an investor in an export trading company includes any affiliate of the investor.

(3) Collateral requirements. Covered transactions between a bank and an affiliated export trading company in which a bank holding company has invested pursuant to this Subpart are subject to the collateral requirements of section 23A of the Federal Reserve Act (12 U.S.C. § 371c), except where a bank issues a letter of credit or advances funds to an affiliated export trading company solely to finance the purchase of goods for which:

(i) the export trading company has a bona fide contract for the subsequent sale of the goods; and

(ii) the bank has a security interest in the goods or in the proceeds from their sale at least equal in value to the letter of credit or the advance.

SECTION 211.34 - PROCEDURES FOR FILING AND PROCESSING NOTICES

(a) Filing notice.

(1) Prior notice of investment. An eligible investor shall give the Board 60 days' prior written notice of any investment in an export trading company.

(2) Subsequent notice. An eligible investor shall give the Board 60 days' prior written notice of changes in the activities of an export trading company that is a subsidiary of the investor if the export trading company expands its activities beyond those described in the initial notice to include: (i) taking title to goods; (ii) product research and design; (iii) product modification; or (iv) activities not specifically covered by the list of services contained in section 4(c)(14)(F)(ii) of the BHC Act. Such an expansion of activities shall be regarded as a proposed investment under this Subpart.

BEST COPY AVAILABLE

(b) Time period for Board action.

(1) A proposed investment that has not been disapproved by the Board may be made 60 days after the Reserve Bank accepts the notice for processing. A proposed investment may be made before the expiration of the 60-day period if the Board notifies the investor in writing of its intention not to disapprove the investment.

(2) The Board may extend the 60-day period for an additional 30 days if the Board determines that the investor has not furnished all necessary information or that any material information furnished is substantially inaccurate. The Board may disapprove an investment if the necessary information is provided within a time insufficient to allow the Board reasonably to consider the information received.

(3) Within three days of a decision to disapprove an investment, the Board shall notify the investor in writing and state the reasons for the disapproval.

By order of the Board of Governors, June 2, 1983.

(signed)William W. Wiles

William W. Wiles
Secretary of the Board

BEST COPY AVAILABLE

Appendix B

EXPORT TRADING COMPANY CASES TO DATE

| Applicant | Date of Board Action |
|---|---|
| Alaska Mutual Bancorporation Anchorage, Alaska | 6/06/84* |
| BankAmerica Corporation, San Francisco, CA | 2/02/84 |
| Bankers Trust New York Corporation, New York, NY | 2/02/84 |
| Chase Manhattan Corp., New York, NY | 2/21/84* |
| Citicorp, New York, NY | 5/31/83 |
| Crocker National Corporation, San Francisco, CA | 8/30/83 |
| First Chicago Corporation, Chicago, IL | 11/21/83 |
| First Interstate Bancorp, Los Angeles, CA | 6/15/83 |
| First Kentucky National Corporation, Louisville, KY | 7/25/83 |
| First National Bancshares, Inc., Houma, LA | 4/06/84* |
| First National State Bancorporation, Newark, NJ | 2/13/84* |
| First Union Corporation, Charlotte, NC | 5/07/84* |
| Fleet Financial Group, Inc., Providence, RI | 3/19/84* |
| Hongkong and Shanghai Banking Corporation, Hong Kong | 12/27/83 |
| International Bancshares Corporation, Laredo, TX | 10/03/83 |
| Manufacturers Hanover Corporation, New York, NY | 4/24/84 |
| Rainier Bancorporation, Seattle, WA | 12/07/83 |
| Ramapo Financial Corp., Wayne, NJ; Ultra Bancorporation, Bridgewater, NJ; and New Jersey National Corporation, Trenton, NJ | 9/14/83 |
| Security Pacific Corporation, San Francisco, CA | 5/09/83 |
| Shawmut Corp., Boston, MA | 12/12/83 |
| Society Corporation, Cleveland, OH | 3/04/84 |
| State Street Boston Corporation, Boston, MA | 9/19/83 |
| Union Bancorp, Los Angeles, CA | 7/25/83 |
| United Midwest Bancshares, Inc., Cincinnati, OH | 10/26/83 |
| U.S. Bancorp, Portland, OR | 11/17/83 |
| Walter E. Heller International Corporation, Chicago, IL | 6/13/83** |

*Acted upon by a Reserve Bank under delegated authority.
**Walter E. Heller International Corporation is no longer a bank holding company.

BEST COPY AVAILABLE

FEDERAL RESERVE BOARD HESITATIONS

Mr. BONKER. Thank you, Mr. Dahl.

I get the impression that the Federal Reserve Board is not terribly excited about export trading companies, or at least banks getting into this activity. Is there a philosophical objection at the Board to banks breaking new ground by getting into this kind of activity through their holding companies? Whereas the Commerce Department is very excited and actively promoting the formation of ETC's, I don't get that same——

Mr. DAHL. I think it is a matter of record, Mr. Chairman, that during the development of this legislation, the Federal Reserve had lots of qualms about the way in which banks and bank holding companies might get involved in it. Congress listened to what the Board had to say about it, and I think that is partly responsible for the rather restrictive role they gave the Federal Reserve in implementing the legislation.

Mr. BONKER. Do you think it is——

Mr. DAHL. Since then, I believe, the regulations we have issued have been consistent with the purpose of the legislation and have been consistent with the spirit intended by the Congress.

FIFTY PERCENT REVENUE TEST AND COUNTERTRADE

Mr. BONKER. I didn't get a sense of the same enthusiastic spirit but it really doesn't matter.

This 50-percent test that you have now imposed as a measure of whether a bank is getting heavily enough into export trade—that is measured over a 2-year period, I understand. Was that an arbitrary figure? How did you come up with 50 percent? I don't think the statute specified 50 percent.

Mr. DAHL. The statute says that they have to be "principally engaged," and the Board interpreted "principally" as it has done under other circumstances, to mean more than half. There are some interpretations that would call for it to be substantially more than half. The Board thought that to reduce it to more than 50 percent would be the most liberal interpretation consistent with the intent of the act to promote exports of goods and services.

Mr. BONKER. Why do you exclude countertrade as a source of revenue for purposes of meeting that test?

Mr. DAHL. What is being excluded are the imports or the other side of the transaction.

Mr. BONKER. So you are just looking at exports?

Mr. DAHL. We are just counting the exports from the United States that come initially, but not the required counterexport from the country in question.

Mr. BONKER. You state that the rationale for this determination, referring to the Bank Export Services Act, is that it is supposed to be export legislation, not trade legislation. Obviously, you don't see the two as representing more or less the same thing.

Mr. DAHL. Well, I think the Board looks on it as the intention of Congress that this was to promote exports from the United States and not world trade in general. I think all of us know the relationship between world trade in general and exports from this country, but——

BEST COPY AVAILABLE

Mr. BONKER. No; I think you are probably accurate in reflecting the congressional mandate in the banking side of the statute.

One reason why the Japanese are so successful in the global marketplace is that their ETC's have a lot of flexibility to engage in all kinds of activity—import, export, countertrade, and so on. It was my hope that, after an initial period, we could expand the scope of the legislation to make it possible for ETC's to be a little more like their Japanese counterparts. Heaven knows, we don't need more imports at the moment. The fact is, however, that all is not well with the global economy. Many countries in Latin America and Eastern Europe no longer have currency to support imports, and so they are compelled to go with some form of countertrade.

I suppose the Board's decision is a matter of interpretation. But I would hope that, in the future, the revenue test might be revised, particularly if countertrade becomes more prominent in the international marketplace.

### COLLATERAL REQUIREMENTS

Do you feel you used much discretion in developing the regulations for the collateral requirement, or were you basing the regulatons specifically on the statute?

Mr. DAHL. On the collateral requirements, we followed first of all the statute. In my statement, I referred to a general exception we made. This was in the light of a specific example, I believe, that was given to us by one or two export trading companies of the kind of financing they were looking for. As I indicated in the statement, the Board is prepared to consider other forms of waiver of the collateral requirements where they would appear to be too burdensome to the financing of export trading companies and would not involve conflicts of interest such as section 23(A) is intended to prevent.

Mr. BONKER. Mr. Warner, do you have any comments on this?

### THIRD COUNTRY TRANSACTIONS

Mr. WARNER. Well, I can give you a few observations, Mr. Chairman, that may be constructive to your interests.

In the area of the countertrade question on the 50-percent revenue test, I think that a number of institutions with early operating experience have indicated their problem is that the countertrade transactions that involve third country contracts, where the goods are never reimported in the United States——

Mr. BONKER. That is right.

Mr. WARNER [continuing]. Constitute a debit in their account. The way trade flows in this day and age, as you have indicated, this is quite common. Their concern is they are really not going to be able to perform the level of services against firm order for their account or for the account of their clients as long as this interpretation remains intact.

Mr. BONKER. Do you think, as Mr. Dahl does, that it is an adequate interpretation?

Mr. WARNER. Well, it is a little difficult for me to visualize how a third country transaction could be viewed interpretively as an

BEST COPY AVAILABLE

import. When we say a third country transaction, as you know from your experience—many of these transactions deal with three, four or five countries, and these goods are distributed all over the world.

The key operative element here is what returns to the United States. It seems to me that, in the end, if the affiliates are successful in returning to the United States, dollars, that is the critical element. Therefore, I would hope that the liberal view would include an interpretation that would allow them, should they be successful, to have that as a credit and, therefore, the export credits remain intact.

Mr. BONKER. Perhaps the Federal Reserve Board simply lacks the concrete business experience to know what is happening in the global economy, and thus takes a rather restrictive, if not parochial, view of these things.

Mr. WARNER. I think perhaps some of the industry comments immediately ahead of you, Mr. Chairman, may help clarify that question.

Mr. BONKER. Mr. Bereuter.

FIFTY-PERCENT REVENUE TEST

Mr. BEREUTER. It is always risky to agree with the Federal Reserve Board, at least in my district.

I believe that Mr. Dahl makes a valid point. Despite what you said about the importance of countertrade, the value of the dollar, the IMF conditions, and that Communist countries inherently have a hard currency problem, countertrade is an increasing factor in the world economy and important to us. I believe that the legislation was drafted to take a look at the definition of export trading companies principally for the purpose of exporting American goods. That is the way Congress wrote it. It is not an international trade-oriented interest, it is export interest. I don't see how the Federal Reserve Board, frankly, can come up with anything else than a 50-percent definition unless it would be higher than 50 percent.

So I would say that the Congress probably didn't think through this subject as clearly as they might have.

Mr. BONKER. Perhaps one explanation, Mr. Bereuter, is that the House Banking Committee, with jurisdiction over the Federal Reserve Board, and its chairman, Mr. St Germain, came into the game late and added an extra inning, a different emphasis, which compels the Fed to do what it is doing.

I think there are two imperatives here—one is to export and one is to develop Japanese-style trading companies so that we may be truly effective. We just have to go one step at a time.

Mr. BEREUTER. Mr. Chairman, I would prefer that myself. I see the advantage in having that. And I don't know the details of how the Banking Committee merged with your effort here in the Foreign Affairs Committee because I was not actively involved in the Banking Committee at that point. I had just arrived or not quite arrived. I have forgotten exactly when it moved through. It is my other committee assignment now.

But if you take a look at title II, the definition, the control seems to be, in section 203, "Export trading company means a company



BEST COPY AVAILABLE

which does business under the laws of the United States or any State, which is exclusively engaged in activities related to international trade, and which is organized and operated principally for purposes of exporting goods or services produced in the United States or for purposes of facilitating the exportation of goods and services."

So "principally" engaged would seem to be, as a minimum, 50 percent. I wonder if perhaps the answer isn't to try to broaden that definition so that we might achieve the objective that you had in mind.

Mr. BONKER. I am sure we can find a consensus. It seems to me that if a company is required to engage in countertrade in order to export its products or services, then that is export related. In other words, if you are turned down in Romania because you can't engage in countertrade, that inhibits exports; conversely, if you can accommodate the countertrade requirements, it will facilitate exports.

Mr. WARNER. Mr. Chairman, I might try to clarify part of our answer for Mr. Bereuter. We did not make a distinction in the Federal Reserve Board's interpretation of "principally" meaning the 50-percent question. That is not at issue.

What was a question that the chairman raised that I assisted in the answer was, in countertrade procedures where you have a third country transaction and goods do not re-enter the United States, the interpretation that they have is that that third country transaction should be counted as an import. Our view is that, as long as the transactions—and that is plural—lead to the ultimate return to the United States of dollars, then that constitutes a successful export.

Mr. BEREUTER. Was that in fact the interpretation that has now been applied?

### PROSPECTIVE NATURE OF REVENUE TEST PROBLEMS

Mr. WARNER. It is not the 50-percent revenue test interpretation, Mr. Bereuter, it is a question of the Federal Reserve in an audit configuration where they believe, when they get to the 2-year audit point, what constitutes imports and exports. In this instance, one would hope that if a company in your district was successful in exporting $1 million worth of merchandise and yet that transaction required a countertrade contract—and the bank was assisting in the management of it, let's say—that should the obligations under that countertrade agreement require exportation from that country, yet those goods and/or services never re-entered the United States, but were distributed in third country transactions, as long as it was reaching a point of liquidity and return to the United States in dollars, then you have successfully completed the export transaction. You have had to go through a number of legs to do it, which is unfortunate, but——

Mr. BEREUTER. I think I agree with your interpretation.

Mr. WARNER. Thank you, sir.

Mr. BEREUTER. But have we reached the point where we have that kind of experience and where the Federal Reserve Board has

BEST COPY AVAILABLE

made that kind of decision? I gather we have not reached that point, and you are concerned about how they may apply it?

Mr. WARNER. One of the concerns—not to answer for the Board obviously—but one of the concerns that a bank ETC would have under their current operations that immediately is concerned with countertrade functions is what they can do for their account or the account of a client on a current market basis that is fraught with countertrade considerations. They will not move forward if they think this is going to be adversely affecting their audit.

Mr. BEREUTER. Is there an example of a problem like this, or is this potentially the concern that you have?

Mr. WARNER. I think, as I answered the chairman earlier, Mr. Bereuter, you will find when the industry testifies, they will give you illustrative examples of this issue.

Mr. BEREUTER. To Mr. Dahl, in fact, is this the interpretation that you would apply to revenue coming back to an export trading company, revenue gained from a business transaction involving trade between two other countries, but expedited or facilitated by an American export trading company?

Mr. DAHL. Well, it seems to me that third country trade, we are not calling it imports, we are just saying these aren't export revenues.

Mr. BEREUTER. Correct.

Mr. DAHL. It seems to me that you have the same question whether you are talking about them being active in third country trade, whether countertrade is involved or not.

You, Mr. Chairman, referred to the performance of the large Japanese trading companies. They operate on a daily basis in the billions of dollars in third country trade, and they get large revenues from that. But that you cannot say is an export revenue from this country. It is not a revenue that is producing jobs in this country. That is the sort of general economic viewpoint, I believe, we are taking at the Board for a bill that had as its intent, as you point out, Congressman, to promote exports from the United States. But I think we are confined to interpreting it in the way that we have, that we can only count as revenues for being principally engaged those that are generated from facilitating or actually dealing in exports of goods and services from the United States.

Mr. BEREUTER. I am afraid I come down with the view, at this point at least, that Mr. Warner has legitimate interest in pursuing it as he would like to see it pursued, and that this is probably consistent with many in the Congress, that you are left with no reasonable alternative than the definition you have written based upon the statutory direction given to you.

I yield back, Mr. Chairman.

### BANK ETC APPLICATIONS AND APPROVALS

Mr. BONKER. You say that 28 banks have applied for certification?

Mr. DAHL. Yes.

Mr. BONKER. And all but one have been processed and approved?

Mr. DAHL. No; all of them have been processed and no objection has been raised. My only point was I think all of them were proc-

BEST COPY AVAILABLE

essed in the 60-day period except one where it was extended for 30 more days.

Mr. BONKER. I think that is a pretty good record of giving immediate attention to the applications. Are most of those banks located on the west coast?

Mr. DAHL. No; I think they are scattered across the country, Mr. Chairman. If you would look at the list contained in appendix B, there are a number on the west coast, including one now in Anchorage, AK, but they are also in Chicago, Louisville, KY, New Jersey, North Carolina, Rhode Island——

Mr. BONKER. Any big money-centered banks?

Mr. DAHL. Pardon?

Mr. BONKER. Any big money-centered banks?

Mr. DAHL. Oh, yes, Manufacturers Hanover, Citicorp, Chase, Bankers, Security Pacific.

Mr. BONKER. Is that list in your statement?

Mr. DAHL. Yes, sir; appendix B of my statement.

Mr. BONKER. OK. Mr. Dahl, what is a typical bank application? We say that they can form ETC's through their holding companies, the equity owners. They can go into this in a very limited way, or in a full way. They can hold title to goods under certain conditions. But what I see in the Northwest are banks that are principally developing a framework but not putting a whole lot into it at the moment. Is that generally what is happening, or are banks getting into this in a big way?

Mr. DAHL. My impression is, Mr. Chairman, that they are getting into it step-by-step. They have some initial ideas about the things they might like to try, but until they finally get organized and actually try to put those in place, they are not quite sure which direction they are going to succeed in.

Mr. BONKER. Are some of the larger banks reluctant to move too dramatically, given the world debt problems? In other words, do the banks that are now overextended, because of earlier loans to Latin American countries, see this as a way to recover their projected losses over a period of time? Or are they less anxious to move in this direction, given their recent unfortunate experience with international loans?

Mr. DAHL. Mr. Chairman, I don't believe I can give you an adequate answer to that question. Some of the largest banks have assembled fairly sizable staffs for this early in the game to conduct and plan their activities. The recent developments may have restrained some of the medium-sized banks, and those that are at an earlier stage of development even, in pressing forward. But I cannot cite you chapter and verse on that.

### HINDRANCES TO ETC FORMATION

Mr. BONKER. Mr. Warner, I think one of the problems for smaller companies who may want to get into trade is the lack of information. To a certain extent, this is being addressed by all the conferences, workshops, and seminars that are taking place. It will require time, however, to expand trade to where it benefits a larger segment of American industry. In the past, smaller companies

BEST COPY AVAILABLE

simply have not had the access, and have had difficulty making the financial commitment.

Let me ask you two questions relating to this. One is, Does it cost a lot to go through the application process in terms of legal fees, and so forth? Could that be an impediment? No. 2, do you have any idea whether the financial requirements of setting up and maintaining an ETC may be too great for many of these smaller companies to move in this direction?

Mr. WARNER. First, Mr. Chairman, I think that our experience so far in counseling in the certificate process would indicate that one can, even with minimal counsel expenses, go through the certification process, I think, very cost effectively, certainly compared to the value of that certificate once they have it. A lot of the cost, obviously, reflects the complexity of the submission; the issues addressed; and the dimension of the conduct envisioned.

In each instance, though, where it becomes as a matter of fabric more complicated, usually the value of that certificate becomes ever higher. Therefore, it is not directly proportionate, but there is that trend.

Mr. BONKER. Don't they have to include in their application rather detailed information about the products and the companies involved?

Mr. WARNER. Yes; it is fairly comprehensive. But I think most of it you will find is a variety of information that they would have pretty much in hand as a corporation anyway. They are fairly fundamental pieces of information. It would occur to me that most of their investment would be with legal and accounting advice, and that would depend directly upon how complex the antitrust issues that they intend to bring into the certification process.

The next part of your question, Mr. Chairman, is the capitalization issue. I think the amount of money that would be required in operating an ETC is relevant to many other venture capital functions. It depends upon what your business plan is. I think it becomes very capital intensive when you tend to, take title very frequently. Here is where you are at risk—your own capital is involved. Those who are primarily concerned with agency functions can be fairly thinly capitalized, much like the historical export management companies. Here again it is the question of the title issue and what they intend to do as a method of operation. The deeper they wade in and take title and make foreign distribution, thereby tying up their capital, it puts more financial pressure on them.

### ETC ELIGIBILITY FOR DISC/FSC TAX BENEFITS

Mr. BONKER. I would hope that, in the next round, we could put some additional incentives into the program. For instance, ETC's qualification or eligibility for DISC tax benefits—as we wanted to do in the original bill but deferred to Ways and Means. In their rewrite of that law—could be a significant incentive for ETC formation. Sam Gibbons had assured me he would put something in that bill regarding export trading companies, but unfortunately the House version did not address ETC's; and we don't know what the

BEST COPY AVAILABLE

final outcome will be of the current Senate-House conference. Would DISC/FSC eligibility be a benefit?

Mr. WARNER. I think any incentives that you can put into the picture——

Mr. BONKER. Would be of benefit?

Mr. WARNER. Absolutely. There is no question about it.

Mr. BONKER. Let me ask you about DISC. It has to be rewritten in order to meet GATT requirements. Any company that is going to qualify must have a presence abroad, they must have an office, or a director on their board——

Mr. WARNER. A foreign presence.

Mr. BONKER. Yes; it seems to me that many smaller exporters that benefit from DISC may not achieve similar benefits under this new tax program. I wonder if it would be possible for an ETC to be formed as a means of allowing three or four companies to meet the eligibility requirements through a DISC and have an office in the Virgin Islands or somewhere to technically meet the requirements?

Mr. WARNER. My understanding, Mr. Chairman, is that the DISC-FSC legislation has been prepared so that it is compatible with ETC operations.

Mr. BONKER. It has?

Mr. WARNER. Yes, sir. That is certainly my understanding on a pro forma basis. Obviously, we will have to wait and see whether it survives.

The issue of foreign presence in the cost to small- and medium-sized corporations has been, I think, reviewed at length. If it survives, and I trust it will, there is a provision in the foreign sales corporation proposed legislation for representative foreign sales corporations which would allow the type of consolidation of interests that you have addressed, keeping in mind that it would still qualify for the foreign presence as defined in the act.

Mr. BONKER. We also had a provision in the earlier bill for SBA loans—a kind of venture capital from the Government to encourage the formation of ETC's. That was taken out, too. A lot of things were taken out when we finally got to the floor. Would that be helpful?

### EXIMBANK LOAN GUARANTEES

Mr. WARNER. Well, I think the section 206 provisions that you have in title II that give the Export-Import Bank its first domestic authority can be reviewed and perhaps——

Mr. BONKER. Let's talk about that, and maybe Mr. Dahl has some comments. Exim has a role by way of loans or loan guarantees, but only if local banks aren't interested. Have we seen actual cases where Exim has been involved in the formation of an ETC?

Mr. WARNER. To my knowledge, they haven't specifically been the ETC's. The way section 206 was written, it can be any exporter, whether it be a manufacturer or an export trading company. So there is, by definition, a broad range of clientele that can have access to the benefits of section 206. In this instance, though, of course, it is expressly written to permit only credit guarantees for export purposes, which is certainly understandable.

BEST COPY AVAILABLE

But it is the window that I would view as immediately available to exporters, be they export trading companies or manufacturers, whatever. As long as their working capital requirements are concerned with export, then the eligibility is there, and the American banking system can come in at any time. There are hundreds of banks that have had extensive experience with Eximbank that would knowledgeably bring in a prospective borrower. Of course, they would have to meet that key Federal hurdle that says that the loan could not be made without the assistance of Exim, but then you would have similiar hurdles with SBA as well.

Mr. BONKER. Mr. Dahl, do you have any comments?

Mr. DAHL. No.

Mr. BONKER. I know what the mandate is, and I think they are doing a pretty good job. They have set up a program and have material published. We have had them participate in workshops. I haven't seen much in the way of direct benefits however, because the true requirements are that the private credit market is not providing adequate financing. How do you determine whether or not the private market is offering the financing?

Mr. WARNER. It requires a bank to make an affirmative statement that this credit would not be available for the purposes defined without the Exim authority. It means that the credit requirement would exceed any normal borrowing or conventional credit consideration that a bank could make.

Simply put, they might lend $200,000, but they won't lend them $600,000 or $800,000, which then would require the Federal wrap-around through section 206. There have been, I believe, 10 or 11 loan guarantees that have passed the——

Mr. BONKER. There have?

Mr. WARNER. Yes, sir. But I could not tell you that they were ETC's. If my memory serves correctly, I think they were all exporters.

Mr. BONKER. Thank you. Mr. Bereuter, any more questions?

Mr. BEREUTER. No, thank you.

Mr. BONKER. I want to thank both of you for being our lead-off witnesses in what we hope will be a productive series of hearings on export trading companies. We will be working closely with you and your staffs as we continue these hearings.

Mr. WARNER. We will remain at your call, sir.

Mr. BONKER. Thank you, Mr. Warner. Thank you, Mr. Dahl.

The subcommittee stands adjourned.

[Whereupon, at 4 p.m., the subcommittee was adjourned, to reconvene subject to the call of the Chair.]

BEST COPY AVAILABLE

BLANK PAGE

# OVERSIGHT OF THE EXPORT TRADING COMPANY ACT OF 1982

WEDNESDAY, AUGUST 1, 1984

HOUSE OF REPRESENTATIVES,
COMMITTEE ON FOREIGN AFFAIRS,
SUBCOMMITTEE ON INTERNATIONAL
ECONOMIC POLICY AND TRADE,
*Washington, DC.*

The subcommittee met at 2:23 p.m., in room 2200, Rayburn House Office Building, Hon. Don Bonker (chairman of the subcommittee) presiding.

Mr. BONKER. The Subcommittee on International Economic Policy and Trade will come to order. Today we meet to continue our series of oversight hearings on the Export Trading Company Act, which was signed into law in the last session of Congress.

At the first hearing, the subcommittee heard from two agencies of the Federal Government: the Department of Commerce and the Federal Reserve Board. Today we hear from the other agencies involved—the Justice Department and Eximbank and a representative of the banking community that has formed a trading company, Citibank.

Implementation of the Export Trading Company Act is still in the early stages, and hold considerable potential for American exporters. Based on earlier testimony, however, the number of filings has not come up to our expectation, particularly with regard to small- and medium-sized companies. We had hoped they would eagerly and swiftly take advantage of the new provisions in the bill that enable them, collectively, to seek out new export opportunities.

Hopefully, the oversight hearings will help to enlighten the subcommittee as to possible changes in the law—ways in which we can enhance the formation of export trading companies—so as to better achieve our export potential in world markets.

I am particularly pleased that William Draper, the President and Chairman of the Export-Import Bank is here. The legislation assigns Eximbank a significant role, and it has moved very early to develop the necessary procedures to be an important contributor to the formation of ETC's in the future. We are anxious to hear from Mr. Draper on the progress that has been made in his agency.

At this time, I will call upon the ranking minority member of the subcommittee, Mr. Roth.

Mr. ROTH. Thank you, Mr. Chairman. I would like to compliment you for holding these hearings, because I think that they are very



BEST COPY AVAILABLE

important. Because we have some votes on the floor votes and time is of the essence, I ask that my opening statement be entered into the record.

Mr. BONKER. Without objection, so ordered.

Mr. ROTH. Thank you.

[Mr. Roth's statement follows:]

PREPARED STATEMENT OF HON. TOBY ROTH, A REPRESENTATIVE IN CONGRESS FROM THE STATE OF WISCONSIN

I would like to thank the Chairman for holding this set of hearings on the implementation of the Export Trading Company Act. I am particularly interested in hearing from the U.S. Export-Import Bank and its progress in launching its test-marketing program in the state of Wisconsin. It has been close to two years now since the President signed the ETC Act which directed Eximbank to extend working capital loans to U.S. exporters. Since the inauguration of the Working Capital Program only 17 applications have been approved—and most of those have been in recent months. Certainly, as with all start-up programs, there are problems to iron out—printing application forms, for example. A lot of time has been lost, and the need is still great among our exporters, particularly the small and medium-sized exporter, to have access to worker capital for export purposes. The Secretary of Commerce, Malcolm Baldrige noted at my Export Conference that I sponsored in Wisconsin two weeks ago that only 1 percent of U.S. firms account for over 60 percent of U.S. exports! With trade deficits now becoming chronic, we must be concerned with increasing the base of U.S. exporters in this country.

I look forward to hearing from our witnesses today on this important subject.

Mr. ROTH. I am particularly interested in this hearing because the U.S. Export-Import Bank is in the process of launching a test marketing program in the State of Wisconsin. Mr. Chairman, during our recent recess, I had quite a group assembled for a conference in Appleton, WI. We had some 400 executives attending from throughout the State.

And being that you were unable to be our keynote speaker, I asked the Secretary of Commerce, Malcolm Baldrige, to be there, and he was. We had an excellent conference. And I want to thank you, too, for helping me in that regard.

Mr. BONKER. I am interested in knowing why we did not have a test marketing program in the State of Washington. [Laughter.]

Ms. Snowe, do you have any opening comments?

Ms. SNOWE. I do not, Mr. Chairman. Thank you.

Mr. BONKER. Mr. Draper, we are very pleased to have you today. I am looking forward to your testimony.

## STATEMENT OF WILLIAM H. DRAPER III, PRESIDENT AND CHAIRMAN, EXPORT-IMPORT BANK

Mr. DRAPER. Mr. Chairman and members of the committee, I am delighted to appear before the subcommitee to discuss the Export-Import Bank's Working Capital Guarantee Program, which came out of the Export Trading Company Act of 1982 that you spoke of.

### EXIMBANK'S WORKING CAPITAL GUARANTEE PROGRAM

This landmark legislation to increase U.S. exports was signed by President Reagan on October 8, 1982. Our Working Capital Guarantee Program was approved by the Eximbank's Board of Directors on January 25, 1983. Since then, we have been actively spreading

BEST COPY AVAILABLE

the word that the program is in place, and we have been developing new initiatives to facilitate use of the program.

Under our Working Capital Guarantee Program, Eximbank assists U.S. companies, especially small and new-to-export firms, to obtain working capital needed for export-related projects such as inventory purchases or the development of export marketing programs. This preexport financing supplements the Bank's other programs that help finance export contracts.

In accordance with its charter, Eximbank supplements and encourages, and does not compete with, private financing. Therefore, our Working Capital Guarantee covers loans that would not otherwise have been made by commercial lenders. The Bank is also charged with finding reasonable assurance of repayment on any financing it supports.

Under the Working Capital Guarantee Program, we look to the creditworthiness of the exporter for such assurance. A creditworthy exporter will have appropriate capital to put the company on a sound footing. It will have management with the skills and the experience to make the venture a success. And it should have adequate collateral to back up the loan.

COLLATERAL REQUIREMENTS

The types of collateral which may be offered to secure an Eximbank guaranteed loan are much broader than those normally accepted by commercial lenders. In addition, Eximbank will guarantee loans for as much as 90 percent of the value of the collateral, a much higher percentage than is normally available commercially.

Eximbank's guarantee covers 90 percent of the principal amount of the loan and interest up to the U.S. Treasury borrowing rate for comparable maturities, plus 1 percent. The lender is at risk for 10 percent of the principal and any interest over the guaranteed rate.

Since inception of the program, Eximbank has been spreading the word of its availability.

Mr. BONKER. I am sorry to interrupt, but while we are on collateral——

Mr. DRAPER. Yes.

Mr. BONKER. Does your regulation call for 110 percent collateral from participating companies?

Mr. DRAPER. It calls for collateral that would be—we will make a loan, and we will guarantee 90 percent of a loan that is in turn 90 percent of the amount of the collateral. Now the answer, therefore, is approximately 81 percent coverage. Typically, the commercial bank will allow 50 percent on inventory.

Mr. BONKER. I thought, based on information from your office, that the collateral requirement——

Mr. DRAPER. Is 110 percent?

Mr. BONKER. Of an eligible lender.

Mr. DRAPER. Well, that is the flip side of that. In other words, we require 110 percent collateral for the loan which in effect means that we will cover 90 percent of the loan. The numbers are not precise. I mean the 110 versus the 90 percent. That is a quick reading of it. A bank would typically require let's say 140 or 150 percent.

BEST COPY AVAILABLE

Mr. BONKER. So your 110 percent requirement of the outstanding loan balance is actually lower than what normal banks would require?

Mr. DRAPER. That is correct. It is more competitive than the commercial banks.

Mr. BONKER. Thank you. I am sorry to interrupt.

Mr. DRAPER. No; that is all right. It causes some question, and you are not the first to raise it.

### EXIMBANK OUTREACH

Since inception of the program, Eximbank has been spreading the word of its availability. We have developed and distributed informational materials describing the program. We have been participating in the export trading company seminars conducted by the Department of Commerce.

We are also conducting our own series of seminars for small businesses and commercial lenders to introduce them to the Working Capital Guarantee Program, and our other services that are especially useful to smaller exporters.

We are launching an extensive test-marketing campaign in a four-State area: Illinois, Michigan, Minnesota, and Wisconsin. We will be trying a number of initiatives in the four States and monitoring their success in order to develop a national program. For example, we will delegate authority to commercial lenders, allowing them to approve Eximbank guarantees on working capital loans of up to $300,000. In fact, they have the discretion to commit us.

### COOPERATION WITH SMALL BUSINESS ADMINISTRATION

To facilitate the use of the Working Capital Guarantee Program nationwide, we reached a new agreement with the Small Business Administration. SBA now offers an Export Revolving Line of Credit Program which guarantees credits of up to $500,000.

Under the new agreement, the SBA will consider transactions of up to $1 million with SBA covering $500,000 and Eximbank covering $500,000. The agreement will help Eximbank tie into the network of banks doing business with the SBA. It will also open the doors of more than 100 SBA field offices to exporters whose needs exceed $500,000. Of course, we will continue to offer the program directly from Eximbank as well.

### SUCCESS OF WORKING CAPITAL GUARANTEE PROGRAM TO DATE

When our program was introduced, worldwide recession, a strong dollar, and debt problems in many markets had reduced demand for U.S. exports. These factors combined with the newness of our program and the inexperience of potential users in working with us kept applications at a low level.

In addition to the slow pace of applications, our early experience with the program also included several requests for assistance that were either incomplete or inappropriate under this program. Some lenders sent us proposals in which business plans were either lacking or not well defined. Some tried to pass off to the Government problem customers from whom they were unable to collect.

BEST COPY AVAILABLE

To address these problems, we have devised new application forms and instructions to lenders that we believe will clearly outline all needed information. We also adopted new procedures for speeding up our own review of applications, including visits by Eximbank loan officers to the exporting companies.

We have received 42 applications for working capital guarantees since the program began. And of these, 14 were either withdrawn by the applicant, or were returned by Eximbank's staff, because they failed to meet the general guidelines of the program. Seven are now under staff review, and 21 have been completed and presented to the Board of Directors for consideration.

We approved 17 at the Board level, and denied 4 for lack of creditworthiness. The 17 guaranteed loans total $20.2 million, including many revolving credit lines permitting numerous export shipments. Each of the exporters receiving Eximbank guaranteed loans to date has been a small business or a business that was new to exporting.

Our most recent guarantee, for example, covered $2.5 million in financing from Allied Memorial Bank of Texas to International Chip and Associates, Inc., a Houston export trading company formed in November 1983. This company makes export shipments from Mobile, AL.

The new company had experienced management, and it had received a long-term sales contract to sell wood chips to a customer in Finland under a letter of credit from a European bank. Allied Bank would lend only 50 percent against inventory and 80 percent against eligible receivables. These limitations would have created a cash-flow deficit for the company.

Eximbank's guarantee covering 90 percent of collateral provided the company with a positive cash-flow and enabled the transaction to go forward. With export shipments scheduled every 45 days, this $2.5 million credit line could generate $20 million in new exports in 1 year.

The United States economy is now booming, and U.S. export sales have once again begun to grow. As we look ahead, we expect that the use of our Working Capital Guarantee Program will grow as well.

While our Working Capital Guarantee Program came out of the Export Trading Company Act, it is not limited to use by export trading companies. It is most helpful to small businesses, ETC's and others. Small business represents the greatest potential source of new growth, of increased exports, and new employment for our country. I am proud of the part that Eximbank is playing to help them realize this potential.

Thank you, Mr. Chairman. I am happy to answer any questions that you have.

[Mr. Draper's prepared statement follows:]

BEST COPY AVAILABLE

## Prepared Statement of William H. Draper III, President and Chairman, Export-Import Bank

Mr. Chairman and Members of the Committee:

I am delighted to appear before this Subcommittee to discuss the Export-Import Bank's Working Capital Guarantee Program which came out of Title II, Section 206, of the Export Trading Company Act of 1982 (P.L. 97-290).

This landmark legislation to increase U.S. exports was signed by President Reagan on October 8, 1982. At that time, the Bank immediately set out to develop the new program of guarantees for loans to U.S. exporters that was called for in the legislation. Our Working Capital Guarantee program was approved by the Bank's Board of Directors on January 25, 1983. Since then, we have been actively spreading the word that the program is in place, and we have been developing new initiatives to facilitate use of the program.

Eximbank's Working Capital Guarantee Program

Under the Working Capital Guarantee program, Eximbank assists U.S. companies, especially small and new-to-export firms, to obtain working capital needed for export-related projects, such as inventory purchases or the development of export marketing programs. This pre-export financing

BEST COPY AVAILABLE

supplements the Bank's other programs that assist in financing export contracts.

In accordance with its Charter, the Bank supplements and encourages, and does not compete with private sources of financing. Therefore, our Working Capital Guarantee covers loans that would not otherwise be made available by commercial lenders. The Bank is also charged with finding "reasonable assurance of repayment" on any financing it supports. Under the Working Capital Guarantee program, the Bank looks to the creditworthiness of the exporter for such assurance. A creditworthy exporter will have appropriate capital to put the company on a sound footing, management with the skills and experience necessary to make the venture a success, and adequate collateral to back the loan.

The law specifies that loans may be ". . . secured by export accounts receivable or inventories of exportable goods, accounts receivable from leases, performance contracts, grant commitments, participation fees, member dues, revenue from publications, or such other collateral as the Board of Directors may deem appropriate. . . ." The types of collateral which may be offered to secure an Eximbank-guaranteed loan are much broader than those normally accepted by commercial lenders. In addition, Eximbank will guarantee loans for as much as 90 percent of the value of the collateral, a much higher percentage than that normally available commercially.

The term of these working capital loans generally will range from one month to one year, but may be of longer duration if required. Eximbank's guarantee covers 90 percent of the principal amount of the loan and interest up to the U.S. Treasury borrowing rate for comparable

BEST COPY AVAILABLE

maturities, plus one percent. The lender is at risk for 10 percent of the principal and any interest over the guaranteed rate.

Communications Efforts

Since inception of the program, Eximbank has been spreading the word of its availability. We have developed and distributed informational materials describing the program. We have been participating in the Export Trading Company seminars conducted by the Department of Commerce. We are also conducting our own series of seminars for small businesses and commercial lenders, to introduce them to the Working Capital Guarantee program and our other services that are especially useful to smaller exporters. During the current fiscal year, we have held 31 small business seminars in 21 states and have scheduled 9 more before the end of September. Attendance at individual sessions has been as high as 200, with a total of 2,818.

We have had special working meetings with panels of exporters, export trading companies, banks and insurance brokers, with associations, such as the National Association of State Development Agencies, and with trade finance specialists from the Department of Commerce and the Small Business Administration.

We have described the program to many companies calling Eximbank's toll-free hotline telephone number (800-424-5201) to request advice and assistance on export-related matters. The advisory service has been especially active this year. In the first half of FY 1984, 5,500 calls for assistance were received on the special number. In the month of February alone, we received 1,456 calls--the highest monthly total since the service was initiated five years ago.

BEST COPY AVAILABLE

New Initiatives

In addition to spreading the word that our Working Capital Guarantee is available, we are working to improve access to the program.

We are launching an intensive test-marketing campaign in a four-state area: Illinois, Michigan, Minnesota and Wisconsin. We are being joined in this effort by a number of field support groups which include the Department of Commerce and representatives of the four state governments.

We will be trying a number of initiatives in the four-state area and monitoring their success, in order to develop a national program. One of the initiatives we will be trying out in these states will be the extension of delegated authority to commercial lenders, allowing them to approve Eximbank guarantees on working capital loans of up to $300,000 per qualified exporter.

To facilitate use of the Working Capital Guarantee program nationwide, we have reached a new agreement with the U.S. Small Business Administration which we expect to be signing in the next two weeks. SBA now offers an Export Revolving Line of Credit (ERLC) program which guarantees credits of up to $500,000. Under the new cooperative arrangement, the SBA will be able to consider transactions of up to $1,000,000, with SBA covering $500,000 and Eximbank $500,000. The agreement will help Eximbank to tie into the existing network of banks doing business with SBA. It will also open the doors of the more than 100 SBA field offices to exporters whose needs exceed $500,000. Of course, we will continue to offer the program directly from Eximbank as well.

BEST COPY AVAILABLE

Eximbank's Experience

When our program was introduced, U.S. exports were declining for a number of reasons that are familiar to us all. Worldwide recession, a strong dollar and debt problems in many markets reduced demand for U.S. exports of goods and services. These factors, combined with the newness of our program and the inexperience of potential users in working with us, kept applications at a low level.

In addition to the slow pace of applications, our early experience with the program also included several requests for assistance that were either incomplete or inappropriate under the program's guidelines. Some lenders sent us proposals in which business plans were either lacking or not well defined. Some tried to pass off to the Government problem customers from whom they were unable to collect for various reasons, including insolvency. To address these problems, we devised new application forms and instructions to lenders that clearly outline all needed information. We also adopted new procedures for speeding up our own review of applications, including visits by Eximbank loan officers to the exporting companies. These changes are improving the quality of initial applications and reducing processing time.

Since our program was inaugurated, we have received 42 applications for Working Capital Guarantees. Of these, 14 were either withdrawn by the applicant or returned by Eximbank's staff because they failed to meet the general guidelines of the program. Seven are now under staff review. Twenty-one have been completed and presented to the Board of Directors for consideration. We approved 17 and denied four for lack of creditworthiness.

BEST COPY AVAILABLE

The 17 approved transactions total $20.2 million. Each of the exporters receiving Eximbank-guaranteed loans to date has been a small business or a business that was new to exporting. The export sales generated by these working capital loans exceed the loan amount. Many of the loans are revolving credit lines permitting numerous export shipments over a one-year period.

Our most recent guarantee, for example, covered $2.5 million in financing from Allied Memorial Bank of Texas to International Chip and Associates, Inc., a Houston export trading company formed in November 1983, which makes export shipments from Mobile, Alabama. The new company had experienced management and a long-term sales contract to sell wood chips to a customer in Finland under a letter of credit from a European bank.

Allied Bank would lend only 50 percent against inventory and 80 percent against eligible receivables. These limitations would have created a cash flow deficit for the company. Eximbank's guarantee, covering 90 percent of collateral, provided the company with a positive cash flow and enabled the transaction to go forward. With export shipments scheduled every 45 days, this $2.5 million credit line could generate $20 million in new exports in one year.

When we began our Working Capital Guarantee program, Eximbank entered a new area of operation--helping U.S. exporters to meet their pre-export financing needs. We feel that this program provides a valuable addition to our wide range of programs designed to assist the financing of export contracts.

As we have gained experience in this new area, and as lenders have gained experience in working with the program, its usefulness has grown.

BEST COPY AVAILABLE

We are making every effort to communicate with potential users. We have improved the application process, and we are developing new ways to improve access to the program.

The United States economy is now booming, and U.S. export sales have once again begun to grow. As we look ahead, we expect that the use of our Working Capital Guarantee program will also grow.

While our Working Capital Guarantee program came out of the Export Trading Company Act, it is not limited to use by export trading companies. It is most helpful to small businesses, ETCs and others. Small business represents the greatest potential source of new growth, of increased exports and of new employment for our country. I am proud of the part that Eximbank is playing to help them realize this potential.

Thank you, Mr. Chairman. I will be pleased to respond to any questions.

**ETC USE OF WORKING CAPITAL GUARANTEE PROGRAM**

Mr. BONKER. Thank you, Mr. Draper, for your testimony.

You state on the last page of your testimony that the Working Capital Guarantee Program, which is directed to helping small- and medium-sized businesses get into export markets, came out of the ETC Act, but that it is not limited to export trading companies.

Mr. DRAPER. That is correct.

Mr. BONKER. You say that you have received 42 applications for working capital guarantees. Of these, 14 were withdrawn or rejected, seven are now under staff review, and 21 were completed and presented to the Board of Directors for consideration, of which seventeen were approved and four were denied.

Of these 17 approved transactions, how many related directly to the formation of an ETC?

Mr. DRAPER. Eleven.

Mr. BONKER. So 11 of the 17 related to the formation of an ETC?

Mr. DRAPER. Well, to a trading company.

Mr. BONKER. A trading company.

Mr. DRAPER. Yes; I am not saying that all of them were formed under the ETC Program.

They are trading companies versus manufacturing companies.

Mr. BONKER. So they could be export management firms or almost anything?

Mr. DRAPER. Right.

Mr. BONKER. Is this the only program that Exim has that directly relates to, or assists in, the formation of ETC's? It seems to me that there was another program.

BEST COPY AVAILABLE

Mr. DRAPER. Well, all programs are available to ETC's. All of our programs are available to service companies as well as manufacturing companies. And trading companies are certainly in that category. And we work with them. I have on my advisory committee of 12 people, 1 member who is the president of the Export Trading Association, a trading company association.

So we want to encourage them as much as possible. And I think that this program is the best program that can relate directly to them. Now all of our programs, such as our credit insurance for exports, are available to them. And our direct loan programs are available to their foreign customers.

And we have got a particularly aggressive program trying to reach out to small businesses; and I know that you are particularly interested in that, Mr. Chairman.

Mr. BONKER. Let me assure you that I speak for many in the Congress in expressing appreciation for the Bank's movement in this direction. As you know, there were many who felt that the Bank was there primarily to assist some of the larger corporations. If we are going to be more competitive, we have to facilitate opportunities for small- and medium-sized businesses as well. Given the statements in your testimony and my own observation of your attitude and your policies, it seems that you are moving very much in the direction of helping the smaller companies.

### AVAILABILITY OF COMMERCIAL LOANS FOR ETC'S

In your experience, have banks been reticent in providing loans to help companies set up ETC's?

Mr. DRAPER. No; I do not believe they are reticent to help ETC's get established. I think they tend to go where the business is, where the action is. They are profit motivated, which is the way that we would want them to be. And I think that banks typically—part of it is a lack of understanding. It is a relatively new program. Part of it is that an ETC has a key benefit of certain dispensation, let's call it, from competitive programs that you may want to call monopolistic or trade restrictive in the sense of antitrust type things.

And since they are excluded from that, they do not all need to register with the Government in order to have some of those benefits. And so a small company can get started, form, as in effect, an ETC. And Washington never hears about it, but it becomes a very effective thing through the promotion of this act, I think, where that company might be representing four or five manufacturers, none of whom could afford to have a salesman in Germany.

And, so I think that those companies are being supported by banks where there are profits involved and the possibility of helping them at the same time. And the combination should work quite well.

I do not think that the banks are backing away in any way from ETC's. I think that they see the importance of exports. And if they do not, they are falling behind themselves. And many have formed special export departments just to get involved in this and have helped. I am familiar with some that have really tried to zero in on this Export Trading Company Act.

BEST COPY AVAILABLE

But I think that what you are searching for is how effective has the legislation been. And just because a company does not form through the license here does not mean that it is not happening out there. I think that the whole thing has been a very good thing, even if we get no more licenses through Washington. Because many ETC's operate just as well without a license.

As I understand it, some of the biggest ETC's have not applied for a license. Sears, and General Electric, and so on. We happen to know about them because of their high visibility. There are probably lots of smaller ones. I mean I know that there are lots of smaller ones that have formed just to do the same project.

### COMPETITION BETWEEN BANK AND MANUFACTURING ETC'S

Mr. BONKER. In the first hearing, we received information from both the Federal Reserve Board and the Department of Commerce concerning the number of filings before those respective agencies. The committee was somewhat disappointed that there had not been more small- and medium-sized companies getting into the formation of ETC's.

There are, as you know, several ways to form export trading companies. You can have a large corporation establish an ETC, which as you point out many have done. These corporate ETC's, however, do not have to establish themselves pursuant to this law.

Mr. DRAPER. Right.

Mr. BONKER. Second, banks can set up export trading companies. At least on the west coast, this type of trading company has been fairly prominent, as many of them are getting more heavily involved in Pacific Rim trade.

The last category—which really was what this committee envisioned in enacting the legislation—is the formation of ETC's by small- and medium-sized companies. If they form trading companies pursuant to the act, they must file with the Department of Commerce.

The number of filings, however, have not been as great as we had expected and we are trying to find out why. One of the reasons may be that they do not have access to capital. I wonder if we are seeing a situation where banks are potentially in conflict with the formation of ETC's.

You cited a wood chip example in your testimony. We have a lot of wood chips in Washington State. If four or five companies, who were not large enough individually to export, wanted to set up an ETC and went to one of the major banks in the State, which was itself in the process of setting up an ETC, they would more than likely be turned down because the bank might want to get into a similar market.

Mr. DRAPER. I really doubt that very much. I think that the banks that I know are interested in making loans to good growing customers. And I think that at this stage particularly, even as they are starting their own, I think that if they saw the ability to lend money to other ones, that would be just frosting on the cake. I cannot believe that they would expect to get a monopoly on the trading company. There are too many potentials of going in a variety of ways.

BEST COPY AVAILABLE

But I am not the right person to ask. You really ought to dig into the bankers a bit, and find out.

Mr. BONKER. I intend to do so. I know that in the northwest at least one major bank has acquired an export management firm that specializes in wood products. Even though the bank ETC is through their holding company, that might be a problem.

I pose this not to fault the banks—I think that they ought to be competitive, and I do not care who exports as long as we export more—but to emphasize the importance of Eximbank's role. The answer from the bank is going to be, well, we cannot see fit to extend a loan for whatever reason. That puts you in a critical position, because then they can go to Exim and ask for a loan guarantee that would help establish this ETC.

Mr. DRAPER. Right. We certainly stand available to do it, and we are trying to market the program fast and aggressively. And we are starting just simply because—you know, we do not have a lot of funds to market with, but we are using what we have got in this market-test area of those four States. I apologize for not starting in the State of Washington.

Mr. BONKER. Well, you can always add one.

Mr. DRAPER. But we hope to be out there with the same program before too long. We will see how this works out.

Mr. BONKER. I applaud your efforts in that respect.

Mr. Roth.

PROMOTION ACTIVITIES

Mr. ROTH. Thank you, Mr. Chairman.

Mr. Draper, it has been almost 2 years since the President signed the ETC Act, and we have now a total of 17 approved applications, right?

Mr. DRAPER. Right.

Mr. ROTH. That does not seem to be very many for that period of time.

Mr. DRAPER. I agree.

Mr. ROTH. What is our biggest stumbling block?

Mr. DRAPER. Our biggest stumbling block is lack of knowledge about the program, I think. I think we do need this marketing effort to get off the ground aggressively. We formed a whole new department in the bank under the leadership of the vice chairman, John Bohn. We have got a little money out of OMB to do it; and we are aggressively trying to make that available, I mean that knowledge of the programs available.

We have got some new pamphlets; and we have got Porter & Novelli, an outside public relations firm, to help us in structuring the marketing program. So we have got great expectations for it. But you know, we will have to report back in a year, and hope that it has had some impact in those States.

We are not doing it directly because there are only 344 people in our bank. Our sole office is in Washington. We do not have an office in each of the other cities, therefore we are trying to work through other agencies as our distributors, such as the SBA. Mac Baldrige of the Commerce Department has been very supportive in his efforts to try to turn over some people to help us lead this.

BEST COPY AVAILABLE

Commerce Department's international trade specialists have trained in the bank. They come in, and then they go back out to their State, and go around and really try to sell these programs to the banks, so that they understand it. These are mostly smaller banks that would not know about it, and would have more of an interest in small business. So we are really gearing it toward them, and really sort of hand hold them during this period.

Mr. ROTH. Whenever you ask people to do a job, you know, you have to give them the tools to do a job. But I have heard a lot of people say that application forms for your program are not yet available from the banks.

Is that correct?

Mr. DRAPER. I am sorry, I do not understand. You say the applications?

Mr. ROTH. The forms, the application forms.

Mr. DRAPER. Are not forthcoming?

Mr. ROTH. That standard application forms have not yet been printed.

Mr. DRAPER. I think that we have the forms printed, and so on. I do not think that that is hard. The point is that the whole program kicks off I think in early September, this marketing effort I am talking about. And we will have detailed instructions to the banks concerning financial packages. It is kind of a controlled program.

We have been selling it. I mean the program has been available, forms are available, and I do not think that they are hard to get. I do not think that is a problem. In fact, the form is a very simple couple pages.

But what is needed, because you have got to find that the company is creditworthy—you do not want just somebody who gets incorporated one day and who knows nothing about exports, and says I will borrow a lot of money, and has no management experience or anything—you know, they have got to submit financials for the last 3 years. They have got a couple of other requirements that we request of them.

I do not need to go into it. But there is a series of things that we would like to see in that package. So when you talk about forms, it is not just fill out a form, and we send you the money.

But the commercial bank once they know about the program will be very helpul, because they retain 10 percent of the risk in this.

Mr. ROTH. Since Wisconsin is one of the four States where we are having this intensive test-marketing program, how many of these 17 applications are from Wisconsin?

Mr. DRAPER. I guess that that is one reason that we went there, because I do not know that we have any in Wisconsin at the moment. So I hope a year from now, I will be able to say that we have got quite a basket full. We have none from Wisconsin that we have done.

Mr. BONKER. Washington, Wisconsin, or Maine.

Mr. DRAPER. You are right.

Mr. ROTH. We certainly have a lot of people in Wisconsin who are interested in exporting. There is no doubt about that. We are 13th out of the 48 continguous States. And if we do not have any applications from Wisconsin, then we have to do something to beef up this program somewhere along the line.

BEST COPY AVAILABLE

Mr. DRAPER. That is right, I agree. You have to recognize, there is one other factor that I should mention. These are exporters or potential exporters that cannot get the same sort of financing from their own bank. So it is not just everything that is bankable in Wisconsin that would be available to us. We would prefer that the commercial bank do the whole thing. That is perfect, of course.

But there are a number of cases that fall in between the cracks that need support, and that is where we will come in. It may never be, you know, a huge program, because it will always be the marginal exporter. It is not geared for Hewlett-Packard.

BUSINESS PROFILES OF 17 APPROVED LOANS

Mr. ROTH. Well, of course, these 17 loans are probably to larger firms, also.

Mr. DRAPER. No, no. I have to correct you, sir. Every one of these is a small business; 100 percent of them are small businesses. We expect that that is where the whole thing is going to end up, too. That they will all be small businesses, I mean virtually all.

Forty-seven percent of the companies approved for credits have been in business for less than 3 years; 100 percent are small businesses, and 70 percent had sales of under $10 million. Those are pretty impressive numbers. Now the problem is that we have to get the gross numbers up.

Mr. ROTH. With the tremendous trade deficits that we are having now, we have to do everything we can to engender trade. Our markets are becoming internationalized. If we have these deficits close to $150 billion as is projected, the effects are going to be even worse than our Federal deficit. So it behooves us to take a look at the situation and to do what we can.

What you are doing with ETC's will be very helpful. I know that a lot of people would love to export, but they either do not know how, they need some incentive, or they need some help. I think that is where you come in.

Thank you, Mr. Chairman.

Mr. DRAPER. Thank you very much.

Mr. BONKER. It is ultimately up to Congress to determine whether we are going to export more or import less.

Ms. Snowe.

RELATIONSHIP BETWEEN EXIMBANK AND COMMERCIAL BANKS

Ms. SNOWE. Thank you, Mr. Chairman.

Mr. Draper, I am certainly impressed by your program's outreach, and your efforts to communicate the benefits to companies that might want to be involved in this program.

Can you tell me if the companies that are interested in applying for your program have to be rejected by a commercial lender first?

Mr. DRAPER. There has to be a statement made by the bank that they would not, it is merely a statement to us, that they would not finance these firms. Because if they would, we of course encourage them to do it. We do not compete with the banks. We want to fill in where they will not go.

Mr. BONKER. If the gentlelady would yield.

Ms. SNOWE. I would be glad to yield.

BEST COPY AVAILABLE

Mr. BONKER. I think that you are on the right track.

If a prospective ETC goes to the local bank and is turned down, does the bank inform them that Exim has a loan guarantee program, or is there just a dropoff at that point? I know that is a hard question.

Mr. DRAPER. We would hope that the bank would tell them that this is available. Particularly if the bank is willing to risk 10 percent of the loan instead of a 100 percent, they would be likely to tell them if they themselves knew about it. And then moreover, if they are willing to do that, the bank does retain 10 percent of the risk on that, if they do tell them about it, then they, the bank can apply. The exporter need not try to find his way to our office. The bank can do that.

Now the answer to your question of do they have to be turned down. Not in so many words. In other words, they do not have to write us and say they have tried six banks, and that they have been turned down by them all, and therefore I turn to you. We still have to work with one bank, because they will process the paper.

Ms. SNOWE. So in other words, some of these companies would not have even gone to a bank originally?

Mr. DRAPER. If they did not, we would get them to go to a bank. We would give them some names. But basically, we would like them, of course, to choose the bank.

### SMALL BUSINESS INVOLVEMENT IN ETC FORMATION

Ms. SNOWE. As you said to Congressman Roth, the 17 applications were predominantly or all small businesses, which I gather you define as less than $10 million?

Mr. DRAPER. Well, I just told you that 70 percent were under $10 million; 100 percent are small businesses as defined by the SBA.

Ms. SNOWE. OK.

Mr. DRAPER. It is a little more complicated.

Ms. SNOWE. The rest of the applications, were they all small- and medium-sized businesses as well—that is, the ones that were turned down for whatever reason?

Mr. DRAPER. I think that the great majority were. Yes, they were.

Ms. SNOWE. What do you find is the greatest obstacle for small- and medium-sized business? I know that you mentioned to Congressman Roth the lack of knowledge. Is that generally the case with all of the requests and concerns that might be registered with your program through the toll-free number?

Mr. DRAPER. They need not go through the toll-free number. But I really think that it is a lack of knowing about the program. Or they find in talking to the bank that the bank is willing to do the financing for them.

First, they have to make some kind of a sale overseas. Or if they have not, they have got to have a program that will build up, let's say inventory, that would be expected to be shipped overseas. So that in itself is difficult for a small company of the type that we think of ordinarily. They usually sell locally first.

But if they have a good prospect overseas, if they have a good concept, through this program they can get most of the financing

BEST COPY AVAILABLE

of their inventory. They get 90 percent of their inventory financed by this system. And they could not do that with a commercial bank up to now.

So I think that it is a good program for certain companies, but not necessarily for all companies.

Ms. SNOWE. You mentioned that in the month of February, for example, you received 1,456 telephone calls.

Do callers generally tell you how they came to know about the program? Do these calls help you to find out what works and what does not work?

Mr. DRAPER. I have to be honest. I have not monitored those phone calls myself, so I am not positive exactly how each one came about. And many might just be casual inquiries about the program. Some from students. It is hard to say exactly how all those came. Because it is quite a job just managing, making sure that the ones that are really live possibilities get good treatment.

Ms. SNOWE. How many staff are assigned to this program?

Mr. DRAPER. About five.

Ms. SNOWE. About five.

TEST-MARKETING PROGRAMS

Finally, how did you determine the four State selection for your test marketing——

Mr. DRAPER. There are not five people sitting on the phone.

Ms. SNOWE. Yes, involved in the entire program, right.

Mr. DRAPER. Right.

Ms. SNOWE. How did you select the four States that are involved in the test-marketing area? I am curious, because Congressman Roth said that there were not any applications in Wisconsin.

Mr. DRAPER. We thought, first of all, that it was a strong exporting group of States. Second, it was not biased either toward the Pacific rim or basin, or Europe. It was central, and could go to Latin America, could do quite a bit down there, too. So it was the best balance. It was right in the center of the country.

And we have some States that are very actively interested in export programs, and have given us a lot of support and help. In fact, I did not mention that, but that would be one of our other distributors, the State agencies that are interested in export, like an export bank almost, or an export division of a State that would serve as our marketing arm, one of our marketing arms.

So there would be the banks, the Commerce Department, the SBA, and the States assisting us in our marketing effort. In connection with this effort, we have even developed an umbrella policy; this is a delivery system for our credit insurance, which helps small businesses to the extent that someone else administers the policy. The umbrella policy that is available to a CPA firm or a variety of nonbanks as well as to banks.

So that we are trying to broaden out, and really get some interest, and stimulate some action. It is not easy when you do not know a darn thing about marketing, which I have got to admit. We do not to start with, but we are trying to learn rapidly, and we are trying to use the talent that is out there.

BEST COPY AVAILABLE

The Commerce Department has some great marketeers, and very often no product, you know. And this is a real product that we have got to sell.

Ms. SNOWE. Would you suggest some modifications in the present law?

Mr. DRAPER. The Export Trading Act?

Ms. SNOWE. Yes.

Mr. DRAPER. I think that you have to give it a little time. You cannot force equity or venture capital down the throats, you know. There is lots of that available for a good active project. The real problem is just getting it known, getting the opportunities that are there for people brought to their doorstep, rather than waiting for them to come to Washington.

Ms. SNOWE. Thank you, Mr. Draper, and Mr. Chairman.

Mr. BONKER. I know that you have to run, but I have just one additional question.

Mr. DRAPER. Sure.

INFORMATION REQUIRED OF EXPORTERS

Mr. BONKER. You deal with both the eligible exporter and the eligible lender.

Mr. DRAPER. Right.

Mr. BONKER. And you ask the eligible lender, if in your judgment the eligible exporter is deemed to be creditworthy, for the loan or line of credit. In addition, you require the exporter's business plan, history of activities, 2 years of financial statements, cash flow projections, and summary of management experience.

An average application, however, may have five or six businesses that have come together for the purpose of forming an ETC. Do you ask this information of each of the exporters?

Mr. DRAPER. No, not necessarily. We would not necessarily do that. In other words, it depends on how it is done.

Mr. BONKER. Before you respond, let me read what it says.

Mr. DRAPER. All right.

Mr. BONKER. "Exim will therefore require the following information on each exporter for the loan guarantee." I do not know whether that refers to each application for an ETC, or each of the exporters who are part of that application.

Mr. DRAPER. That refers to the application itself.

Mr. BONKER. Now, if it refers to the application, I would assume that in almost every instance that you would have four or five companies that would come together to form an ETC, and there would not be much of a financial statement or past history, because they are just starting up.

Mr. DRAPER. That is correct. We did one just like that in California. It was a company called World Trade in Computers, Inc. They were planning to ship overseas by buying and reselling equipment from about half a dozen small companies. The companies were not even necessarily specified. Some were, and some were not.

It was a brandnew company formed in 1982. And they have already drawn down $400,000 of loans which we have guaranteed. Now I do not think that it was the balance sheet. But these should be available in the application.

BEST COPY AVAILABLE

Mr. BONKER. So in such cases you would waive the past history and so forth.

Mr. DRAPER. Sure. But we checked the management background, and looked into it as best we could. We do not need, you know, Fort Knox under the balance sheet in order to approve these, because we recognize that they are marginal cases. But they are trying to do a job that we are interested in doing. And if they are good responsible people who have had good records in the past, then that goes a long way.

I came out of the venture capital business myself, for 20 years, and this does not frighten me. Because you check on who the people are, and that can override a balance sheet any day.

Mr. BONKER. Let me illustrate the situation of the exporter. In a normal application that reaches your desk, the applicants would have had to fulfill numerous requirements pursuant to the Export Trading Company Act of 1982. They would have subjected their application to all of the requirements of the Department of Commerce, who would have cleared it with the Department of Justice. Then the applicant would have gone to the bank to meet its requirements, and if the bank felt that the applicant was not creditworthy or that he cannot extend the loan, then they come to your doorstep with yet another set of requirements.

I would hope that the applicant does not have to satisfy a different set of requirements each step of the way in order to provide essentially the same information for the decision makers.

Mr. DRAPER. I suspect that we would not require any more information than has already been submitted to the bank in that case. It is not a complicated thing. It is just—tell us about yourself. Just to get acquainted with the program and the people that we are doing business with and so on, we have sent some of our loan officers out to the plants to make it easier, and help them fill out the forms, find out where the sticking point is, where the problem is. So we are trying to move these along as they come in.

I mean it is a fairly good record, 17 approved out of 42 submitted. I think in that sense there are an awful lot of people just trying to skim through without hardly any experience and that sort of thing. So I think that we are pleased with the ratio, but we are not pleased with the gross number of applications.

### ELIGIBLE LENDERS

Mr. BONKER. We can agree with that. Now let me ask about the eligible lender. Your policy states that "if Exim has no working experience with the lender, 2 years of full financial data to include balance sheets, income statements, corporate ownership, and a brief corporate history will be required to be submitted to Exim."

If the applicant goes to the local bank, and the local bank is interested, but has no past working relationship with Exim, then the bank has got to submit all of this information.

Mr. DRAPER. Yes. But for a bank to submit its last 2 years' of financial statements, that is no big deal.

Mr. BONKER. So that is not a stumbling block?

Mr. DRAPER. No; that should not be a block at all.

BEST COPY AVAILABLE

Mr. BONKER. In other words, an applicant could go to the bank, and if the bank wanted to be sticky about it, it would say, look, we do not have that kind of relationship with Exim. I guess if the bank really wants to get involved, it can, and if it does not, it has a way out, because it doesn't have an established relationship with you.

Mr. DRAPER. It is true that they have to retain 10 percent of the risk, so they are still interested. And we think that is important. Because if we were to try to do this as a bank directly with nobody as a partner, it would get to be a very sticky and bad program. Because, I think that we would end up deluged with bad loans.

Mr. BONKER. Well, we certainly do not want that to happen. You have been very kind, and patient, and informative.

Mr. DRAPER. Incidentally, it does not have to be a bank, Mr. Chairman. It can be a creditor of any type. And therefore, it does not necessarily come under the bank regulations. So therefore, it is good to at least have some kind of information on that creditor.

Mr. BONKER. Credit unions, would they qualify?

Mr. DRAPER. Yes.

Mr. ROTH. Mr. Chairman.

Mr. BONKER. Mr. Roth.

FISH EXPORTS

Mr. ROTH. I just have one short question. And that is in regard to a bill that we had last week, the fish bill, remember that?

Mr. BONKER. Yes.

Mr. ROTH. In the hearing last week, the question arose as to whether fish and fish produce can be financed for export through Eximbank programs, including the Working Capital Program. I wonder if you could comment on that.

Mr. DRAPER. The answer to that question is yes. We will finance fish exports, and have done so to the extent of roughly $2 million a year for the last 3 years. Up to date so far in fiscal year 1984, we have done $1.25 million.

Mr. ROTH. Thank you very much, Mr. Draper.

Mr. DRAPER. Yes, sir.

Mr. BONKER. Thank you, Mr. Draper, for coming. I am sorry for the delay. If your staff could keep our committee informed of developments, it would be helpful. We believe export trading companies are an important adjunct to our export promotion programs, and we see your bank as being instrumental in helping to promote ETC's in the future.

Mr. DRAPER. I wish that everyone in Washington were as involved as the three of you are. And I hope that we can work together to really promote exports in all of your States. Thank you very much.

Mr. BONKER. Mr. Rule, you can tell us about the rules of law that relate to export trading companies.

BEST COPY AVAILABLE

**STATEMENT OF CHARLES F. RULE, DEPUTY ASSISTANT ATTORNEY GENERAL, ANTITRUST DIVISION, DEPARTMENT OF JUSTICE**

Mr. RULE. Mr. Chairman and members of the subcommittee, I understand that the members have copies of my statement. I would ask that it be entered into the record, and I will summarize my testimony this afternoon.

### JUSTICE DEPARTMENT IMPLEMENTATION OF 1982 ACT

I am pleased to be here to discuss the experience of the Department of Justice in implementing the Export Trading Company Act of 1982. The Department recognizes the importance of that act, and we are a strong proponent of its overall purposes. Today I will restrict my remarks to titles III and IV.

The purposes of titles III and IV of the Export Trading Company Act are to clarify the application of the antitrust laws to export trade, and to eliminate uncertainty in that regard that had perhaps existed before the passage of that act.

The Department of Justice has long maintained and still believes that the antitrust laws are generally not an obstacle to export trading activities. We have always taken an interest in and have taken steps to clarify the laws that apply to export trading activities. We have repeatedly indicated that the U.S. antitrust laws are designed to protect the domestic economy and domestic exporters, and are not intended to prevent anticompetitive behavior that does not have a direct, substantial, and reasonably foreseeable effect on U.S., commerce or on the exports of U.S. firms.

Nevertheless, up until the passage of the act in 1982, there was a great deal of uncertainty as to the application of the antitrust laws, at least on the part of some businessmen, particularly perhaps small- and medium-sized businesses. That uncertainty may have inhibited some beneficial export activities by firms, whether competitors or not.

### CLARIFICATION OF ANTITRUST LAWS (TITLE IV)

The Export Trading Company Act went a long way, as I said, to correct that problem. It basically provided the needed certainty in two ways. First, title IV clarifies the jurisdiction of the American antitrust laws over export activity.

That title basically clarifies what has been the position of the Department before its enactment; namely, that the antitrust laws only apply where conduct has a direct, substantial, and reasonably foreseeable effect on domestic commerce or on the exports of a competitor.

Title IV is, one might say, self-executing. It clarifies the law, and no one has to come in to get the benefits of that.

### CERTIFICATION OF LIMITED ANTITRUST IMMUNITY (TITLE III)

The second way that the ETC Act improved certainty and clarified the application of the antitrust laws, in this area was through title III, which provides the mechanism whereby individuals or firms can get limited antitrust immunity for their certified export

BEST COPY AVAILABLE

activities. Title III specifically provides that the Secretary of Commerce, with the concurrence of the Attorney General, can issue export trade certificates of review. Those certificates are issued when conduct for which the application for a certificate is made fits within the statutory terms of "export trade activities and methods of operation," and when the conduct for which the application is made meets four qualifications.

Basically, the act requires that the conduct not substantially lessen competition or result in a substantial restraint of domestic trade or commerce; does not enhance, depress, or stabilize domestic prices; does not constitute unfair methods of competition; and could not reasonably be expected to result in reimportation of goods and services that have been exported.

These requirements, the act's legislative history, and certainly the way that the act has been implemented by us, provide that a certificate may only be issued under circumstances consistent with the antitrust laws.

Title III does not change the antitrust laws. Rather it provides a means for someone to come to the Government and get a certificate that provides some certainty that the proposed, specified conduct will not be found to violate the antitrust laws, or at least will not subject the applicant to potential tremendous amounts of damage liability.

If the certificate is issued, there can be no criminal or civil antitrust suit brought against the covered conduct. However, the Department of Justice can sue to enjoin conduct that threatens clear and irreparable harm to the national interest.

Title III also creates a private right of action for individuals who are injured by conduct that is either erroneously certified by the Government, or conduct that comes to violate any of the four conditions that I mentioned because of changes in circumstances.

Nevertheless, this limited private right of action is far more limited than the current right of action under the antitrust laws in that it allows the plaintiff to receive only actual damages. It also requires the plaintiff to pay defendant's attorney's fees when it loses.

There is a statutory presumption that conduct within the certificate complies with the conditions of the act. Title III also shortens the statute of limitations for filing a damage claim.

### REVIEW OF TITLE III APPLICATIONS

Now I would like to turn briefly to the procedures whereby the Antitrust Division reviews the applications for certificates of review. I will not describe the statutory procedures that are set out in my statement; rather, I would like to explain briefly the way that we handle the review.

The review function has been delegated by regulation to the Assistant Attorney General in charge of the Antitrust Division.

The Antitrust Division receives applications for certificates of review from the Commerce Department within 7 days after the completed application is received by Commerce. An application is then assigned to the section of the Antitrust Division having expertise with regard to the products or services that it involves.

BEST COPY AVAILABLE

An attorney and an economist are assigned to review the application, to do the investigation, and to work very closely with the Department of Commerce. The analysis we use is generally the same as that we would apply when looking at export conduct in other contexts, for example, when issuing a business review letter.

As we have become more accustomed to and more experienced with this procedure, we have been able to facilitate our review and smooth out the procedure. We certainly have impressed upon the staff attorneys and the economists the importance of moving these things along as expeditiously as possible, consistent with making sure that the certificates cover conduct that meets the four criteria in the statute.

Upon completion of the analysis, the staff forwards a recommendation to our Office of Operations, which then reviews it. Operations then forwards its recommendations to the Deputy Assistant Attorney General for Regulatory Activities, who also reviews it. The materials and recommendations are then forwarded to the Assistant Attorney General, who makes the final decision and notifies the Department of Commerce of that decision.

Our analysis, briefly stated, focuses on whether or not the conduct for which the application has been made will have, or is likely to have, a substantial anticompetitive impact on either U.S. domestic commerce or on the exports of competitors. If not, the four conditions in section 303 are generally met.

To make this determination, we look at a number of factors. I suppose the three most important are the purpose of the conduct; the market structure that is involved or surrounds the conduct; and finally, the likely effects of that conduct on competition.

### TYPES OF APPLICANTS

The applications received so far, I think, can be divided roughly into two groups. One involves a single firm that wants a certificate, or perhaps firms that are not competitors but are vertically related, for instance, that have supplier/customer relationships.

Generally speaking, conduct by these firms poses little competitive risk, and we have been able to issue them certificates to that effect. There are a couple of examples of that kind of application. One is Equinomics, Inc., a small, minority-owned general exporting trading company in New Orleans that seeks to represent other companies in exporting; another is the Trade Development Corp. in Chicago, a company that seeks to export a variety of goods to Asian markets.

The certificates granted to these or similar applicants typically certify them to appoint and terminate exclusive foreign distributors, and to be the exclusive export representatives for the U.S. producer.

The second group of applicants potentially can raise other and greater competitive concerns, and can involve agreements among competitors. What competitors do with regard to export trade does not generally have a direct, substantial, and reasonably foreseeable impact on U.S. commerce, and therefore the antitrust laws are not violated by that type of conduct. However, there is always the danger that where there is an agreement involving competitors,



BEST COPY AVAILABLE

they may use that agreement to facilitate collusion somehow in domestic markets. The act is designed to prevent that possibility, and that is largely what we look for when we conduct our reviews.

One of the dangers, for example, might be the exchange of price or other sensitive business information that enables companies to facilitate their domestic pricing of goods. Therefore, we have to scrutinize carefully any potential anticompetitive effects or purposes of such a venture. However, it is important to stress that we also recognize that such ventures frequently have a very beneficial effect, and are very important in enabling companies to compete in the export market and to sell abroad.

### FACTORS INVOLVED IN COMPETITIVENESS DETERMINATIONS

In examining agreements among competitors, we look primarily at the market structure of the industry involved. We look at the number and size of the competitors, the market share of the partners to the agreement, the susceptibility of the market to noncompetitive practices, and the potential of domestic market power on the part of the trading entity.

One of the real concerns is whether a very large percentage of all of the domestic firms is involved in the trading company. However, there have been very few applications to date from such groups. I want to stress, however, that even where there is a large percentage of the domestic industry involved, that does not necessarily mean that we refuse to approve issuance of a certificate. Our decision depends on a number of factors, including the number, size, and identity of the firms remaining outside of the venture, whether or not foreign companies can actively trade in the United States, and a number of other important factors.

Specific examples of certificates that we have issued to groups of competitors include a certificate issued to the United States Farm-Raised Fish Trading Co., a group of competing catfish producers, who are trying to export catfish, and the Northwest Fruit Exporters, a group of Washington and Oregon cherry producers formed to try to meet some of the concerns of complying with Japanese Government requirements.

We are careful—and must be careful—not only to meet our statutory obligations under the act in determining whether or not conduct is anticompetitive, but also to protect consumers. And, of course, that is extremely important and we are used to doing that. I think it is also important to stress that we are very careful and very sure that when we issue a certificate, the conduct is consistent with and complies with the four criteria of the act.

This is because the purpose, of course, of the act is to provide certainty for domestic exporters. And to the extent that we provide too broad or too vague a certificate, or that conduct is not consistent with those criteria, then they will be subject to potential single damage liability, and that cuts against the purpose of the act.

### APPLICATION APPROVALS TO DATE

To update slightly the figures for the applications that have been submitted since June 9, 1983, there have been 65 applications, and 34 certificates have been issued. Nine of the applications are pend-

BEST COPY AVAILABLE

ing. The remainder have been either withdrawn by the applicants and have been reformulated or were found incomplete by the Commerce Department. Many of these have subsequently been resubmitted.

No application has yet been denied, and no certificate has to this date been challenged in court. Applicants have generally been small- or medium-sized companies, as Congress intended when it passed the act.

The Department of Commerce has primary responsibility for the development and promotion of U.S. exports, particularly under title I of the act. We at the Department of Justice do not attempt to duplicate those efforts. We have, however, attempted to get out the word to various groups, lawyers in particular, to explain to them how the Antitrust Division conducts its reviews, and to explain the law and our procedures. I think that we have had some success in that area.

I want to assure the members of the subccmmittee that the Department of Justice recognizes the importance of the act in promoting this country's export trade. Accordingly, consistent with our obligations under the act and our duty to protect American consumers, we endeavor to process applications with a minimum of delay.

Moreover, the Department stands ready to facilitate American industry's efforts to compete internationally. The antitrust laws should not be improperly interpreted or perceived to impede this country's competitive efforts in international markets, precisely because it is vigorous competition and vigorous competitive behavior that the antitrust laws are designed to promote.

Mr. Chairman, that completes my prepared remarks. I would be pleased to answer any questions that the subcommittee might have.

[Mr. Rule's prepared statement follows:]

BEST COPY AVAILABLE

PREPARED STATEMENT OF CHARLES F. RULE, DEPUTY ASSISTANT ATTORNEY GENERAL, ANTITRUST DIVISION, DEPARTMENT OF JUSTICE

Mr. Chairman and members of the Subcommittee:

I am pleased to be here today to discuss with you the Export Trading Company Act of 1982 ("ETC Act" or the "Act") and the way it is being implemented by the Department of Justice. 1/ The Act was passed by Congress under the leadership of Subcommittee Chairman Bonker in an effort to encourage U.S. exports and in the belief that there are many U.S. companies that could--but do not--export goods and services.

Title I of the Act sets forth the Act's purpose to increase United States exports and establishes an office of export trade in the Department of Commerce. 2/ Title II permits bank holding companies and similar entities to become involved in export trading companies. 3/

Titles III and IV are the antitrust titles. 4/ They respond to complaints that the antitrust laws are a barrier to various kinds of export activities. In fact, antitrust laws, properly understood and applied, would prohibit few export activities. Congress concluded, however, that the perception of possible antitrust exposure could deter perfectly lawful

---

1/ Pub. L. 97-290, 96 Stat. 1233-47, signed into law by President Reagan October 8, 1982, and its implementing regulations at 15 C.F.R. Part 325.

2/ 15 U.S.C. § 4001-3.

3/ 12 U.S.C. §§ 1841-43; 12 U.S.C. § 372.

4/ 15 U.S.C. §§ 4011-21.

BEST COPY AVAILABLE

export activities. Accordingly, in Title III of the Act, Congress permitted persons to obtain "certificates of review" that provide limited antitrust immunity for certain export trade activities. Title IV of the Act, the Foreign Trade Antitrust Improvements Act of 1982, clarified the subject matter jurisdiction of the antitrust laws.

Certificates of Review

Title III of the Act provides that the Secretary of Commerce, with the Attorney General's concurrence, may issue export trade certificates of review to any applicant for "export trade, export trade activities, and methods of operation" that meet the standards of the Act. To qualify for a certificate, the conduct must:

> (1) result in neither a substantial lessening of competition or restraint of trade within the United States nor a substantial restraint of the export trade of any competitor of the applicant,
> (2) not unreasonably enhance, stabilize, or depress prices within the United States of the goods, wares, merchandise, or services of the class exported by the applicant,
> (3) not constitute unfair methods of competition against competitors engaged in the export of goods, wares, merchandise, or services of the class exported by the applicant, and
> (4) not include any act that may reasonably be expected to result in the sale for consumption or resale within the United States of the goods, wares, merchandise, or services exported by the applicant. 5/

---

5/ § 303(a)(1)-(4), 15 U.S.C. § 4013(a).

BEST COPY AVAILABLE

Congress intended these standards to be entirely consistent with existing antitrust law. 6/ Congress also sought to clarify the applicability of antitrust law to export-related conduct. In this regard, the amendment to the Sherman Act accomplished by Title IV of the Act clarifies that there is jurisdiction with regard to export trade only when the conduct produces "a direct, substantial, and reasonably foreseeable effect" on domestic or import commerce, or the export trade of other American competitors. 7/ This amendment codifies the mainstream of legal precedent and is consistent with past Antitrust Division practice.

Thus, certificates of review are not intended to immunize conduct that would have anticompetitive effects on domestic commerce and thus would harm U.S. consumers. A certificate is issued only where the conduct would otherwise be lawful under the antitrust laws and meets the requirements of the Act. A certificate provides antitrust certainty, in that a certificate holder receives substantial practical protection from antitrust suits. No criminal or civil antitrust action can be brought against a person who has been issued a certificate of review for conduct specified in, and in compliance with, the

---

6/ "The Conferees intend that the standards set forth in this subsection encompass the full range of the antitrust laws." H. Rep. No. 97-924 (97th Cong. 2nd Sess.) 26 (1982).

7/ 15 U.S.C. § 6a.

BEST COPY AVAILABLE

certificate. 8/ The Act does provide that the Department of Justice may file suit to enjoin conduct threatening clear and irreparable harm to the national interest. 9/

In addition, a person injured by conduct covered by a certificate may challenge the conduct, and if that conduct is found to violate the standards of the Act, the injured person may obtain an injunction and recover actual--not treble--damages. Although successful private plaintiffs may recover their attorney's fees, plaintiffs must pay the defendant's attorney's fees if they do not prevail in the litigation. 10/ Thus, while the Act's substantive requirements for certification do not differ from substantive standards applicable under the antitrust laws, the facts that certificate holders are exposed to single rather than treble damages and that plaintiffs are potentially liable for defendant's legal fees should discourage frivolous or ill-founded challenges to certified export conduct.

Department of Justice Responsibilities and Experience Under Title III

The Act requires that the Secretary of Commerce, with the concurrence of the Attorney General, issue regulations to carry

---

8/ 15 U.S.C. § 4016.

9/ § 306(b)(5), 15 U.S.C. § 4016(b)(5).

10/ § 306(b)(1)-(4), 15 U.S.C. § 4016(b)(1)-(4).

BEST COPY AVAILABLE

out the Act, and further provides that the Secretary of Commerce with the concurrence of the Attorney General may issue guidelines to promote greater certainty regarding the application of the antitrust laws to export trade. 11/ Accordingly, the Department of Justice has worked closely with the Department of Commerce to issue regulations and guidelines. In addition, we have developed our own internal procedures for efficient processing of applications. We held a seminar prior to the Act's effective date for all Division supervisors, and circulated materials explaining the Act and our procedures to all appropriate Division sections and offices.

I would now like to describe how applications are handled at the Department of Justice and the substantive analysis we employ. Throughout, I will incorporate specific references to some of our experiences under the Act.

Any person (not just an export trading company) may file an application for an export trade certificate of review. The Department of Commerce is required to transmit each application within seven days of its submission to the Antitrust Division of the Department of Justice, which has been delegated by the Attorney General to process the applications. 12/ Within ten

---

11/ §§ 310, 307, 15 U.S.C. §§ 4020, 4017.

12/ The Title III functions of the Attorney General were delegated to the Assistant Attorney General in charge of the Antitrust Division. 48 Fed. Reg. 9523, March 7, 1983; 28 C.F.R. §§ 0.40-.41.

BEST COPY AVAILABLE

days of receipt of the application, the Department of Commerce is required to publish in the Federal Register notice of the application identifying the applicants and describing the conduct for which the application has been made. 13/ The confidentiality of the applicant's financial and proprietary business information is protected by an exemption from the Freedom of Information Act 14/ and by disclosure prohibitions on the staffs of the Departments of Commerce and Justice that review the applications for certificates. 15/ The statute requires that the two agencies determine within ninety days whether the application meets the standards for a certificate of review. 16/ The Act and the regulations permit some applications to be processed on an expedited schedule of forty-five days rather than ninety days, if the applicant demonstrates a "special need" for an earlier decision. 17/ No certificate may be issued earlier than thirty days from the date of publication in the Federal Register. 18/ To date, two

---

13/ 15 U.S.C. § 4012(b).

14/ § 309(a) (5 U.S.C. § 552), 15 U.S.C. § 4019.

15/ § 309(b)(1), 15 U.S.C. § 4019.

16/ § 303(b), 15 U.S.C. § 4013(b). This time period can be extended, pursuant to the regulations, if there is a need for additional information. 15 C.F.R. § 325.

17/ § 303(c), 15 U.S.C. § 4013(c).

18/ 15 C.F.R. § 325.7.

BEST COPY AVAILABLE

applicants have requested and received certificates issued on an expedited basis. If a certificate is issued, the Commerce Department publishes a summary of the certificate in the Federal Register. If a certificate is denied, the Commerce Department publishes a notice of the denial. 19/

We assign each application received from the Department of Commerce to a section of the Antitrust Division that has expertise in the products or services involved in the application. An attorney and an economist are assigned to work with Department of Commerce personnel to ensure that we have all the information needed for our analysis and to help prepare an appropriate certificate. We evaluate whether the applicant and the proposed conduct are eligible for certification under the Act and whether the proposed conduct meets the Act's four standards. Because those standards are essentially the competition standards of the antitrust laws, our analysis is essentially the same one we apply to other proposed export conduct under the Department's Business Review Procedure 20/ or in other typical antitrust analysis.

---

19/ 15 C.F.R. § 325.5(c).

20/ Under that procedure, which is set forth at 28 C.F.R. § 50.6, parties may obtain a statement of the Department's present enforcement intention with respect to a specified proposed course of conduct.

BEST COPY AVAILABLE

Upon completion of its analysis, the staff prepares a recommendation which is reviewed in turn by the chief of the relevant section, the Director of Operations, and the Deputy Assistant Attorney General for Regulatory Affairs. The decision whether to concur with the Department of Commerce that a certificate should be issued is made by the Assistant Attorney General in charge of the Antitrust Division.

I turn now to a description of the analysis we must perform to determine whether proposed conduct is certifiable. It is important to emphasize that the Act authorizes no conduct that would otherwise violate the antitrust laws. As you know, Section 1 of the Sherman Act prohibits unreasonable restraints of trade. Thus, our analysis focuses on whether the proposed conduct is likely to have a substantial anticompetitive impact on either U.S. domestic commerce or on the export opportunities of other U.S. exporters. Conduct that has anticompetitive effects only in foreign markets would not ordinarily violate the U.S. antitrust laws and therefore may be certified. However, an export trade certificate of review does not protect U.S. companies from the antitrust laws of other countries.

In general, in determining whether proposed conduct is likely to have an anticompetitive effect in the United States or on U.S. exporters' opportunities, we consider the purpose of the arrangement, the market power of the applicant and other firms that will be involved in the arrangement, and the

BEST COPY AVAILABLE

potential anticompetitive consequences to domestic commerce or to U.S. export competitors that may result.

The applications that we have received can be roughly divided into two groups: one group consists of applications by firms seeking certification for single-firm conduct and vertical conduct--that is, conduct involving a supplier and its customer, as opposed to conduct involving competitors, which is referred to as horizontal conduct; the other group consists of applicants seeking certification for agreements among direct competitors. Applications in the first group, generally proposing agreements between a manufacturer and a distributor, or between a distributor and a foreign sales representative, usually present few antitrust issues. When we look at vertical conduct in connection with exports, we find that such conduct is unlikely to have substantial anticompetitive consequences in the United States. Such conduct--if it takes place in the United States--is usually examined under the rule of reason. 21/

For example, Equinomics, Inc., is a small, minority-owned, general export trading company in New Orleans that seeks to represent other companies in exporting a wide variety of products; the Trade Development Corporation of Chicago is a company that seeks to export to Asian markets phonographic

---

21/ Continental TV, Inc. v. GTE Sylvania, 433 U.S. 36 (1977).

BEST COPY AVAILABLE

records and prerecorded tapes, commercial aircraft, bolts, nuts, rivets, washers, computer programming and software, and management and public relations consulting services. The certificates granted to these or similar applicants typically certify them to appoint and terminate exclusive foreign distributors and to be the exclusive export representative for a U.S. producer.

Applicants seeking certification for agreements among competitors pose a greater possibility of causing anticompetitive effects in domestic markets. For example, the exchange of price or other sensitive business information, and the possibility that the trading entity may be used as a vehicle for illicit agreements or as a means to raise prices in the United States, have potential anticompetitive effects and will be carefully scrutinized. Such agreements may constitute unreasonable restraints of trade that, if implemented, would violate the antitrust laws. However, agreements among competitors also can be procompetitive or competitively neutral and thus not violate the antitrust laws. For example, joint marketing agreements or joint ventures that do not have the potential to restrict output and raise prices may promote competition.

In examining agreements among competitors, we look at the market structure of the industry involved: the number and size of competitors in the relevant market; the market share of the

BEST COPY AVAILABLE

partners to the agreement; the susceptibility of the market to noncompetitive practices; and the potential domestic market power of the trading entity. We are particularly concerned in situations where most or all of the firms in an industry are affiliated and supply is not easily expanded. There have been very few applications to date from groups that represent a large share of the U.S. competitors in a given industry. However, even where a large share of U.S. competitors is involved, a certificate will be issued if the conduct for which certification is sought does not involve significant risks of domestic collusion. This determination will depend on a number of factors, including whether significant competitors (including foreign competitors) remain outside the venture; whether the market structure is conducive to successful collusion, and whether there are adequate limitations or conditions in the certificate.

Specific examples of certificates issued to groups of competitors include: the U.S. Farm-Raised Fish Trading Company, Inc., a group of competing catfish producers that are attempting to develop overseas markets for catfish; and Northwest Fruit Exporters, a group of Washington and Oregon cherry producers that have joined forces to sell cherries to Japan in compliance with Japanese government requirements.

Because certificates of review confer limited antitrust immunity, we must be careful that they describe precisely the

BEST COPY AVAILABLE

conduct that is covered by the certificate. Vague or imprecise language could result in an overbroad grant of antitrust immunity to conduct that was not intended to be covered, or in protection of plainly anticompetitive conduct that arguably is covered by a certificate. Conversely, imprecise language could subject a certificate holder to antitrust liability for conduct that had incorrectly been assumed was covered by the certificate.

Applications for certificates were first accepted on June 9, 1983. Since that time, sixty-five applications have been received and thirty-four certificates have been issued. Nine other applications are pending. The remainder were withdrawn by the applicants when the Commerce Department found that they were incomplete or the applicant decided to reformulate its application; many of these firms subsequently reapplied. No application has been denied, and no certificate has, to this date, been challenged in court. Applicants have generally been small or medium-sized companies, as Congress intended when it passed the Act. 22/

The Commerce Department has responsibility for development and promotion of U.S. exports. We at the Department of Justice do not attempt to duplicate the promotional efforts of the Department of Commerce. We have, however, attempted to educate

---

22/ See § 102(a)(4), 15 U.S.C. § 4001.

BEST COPY AVAILABLE

the antitrust bar about the Act through speeches and participation in educational programs. Let me assure the members of this Subcommittee that we at the Department of Justice recognize the importance of the Act in promoting this country's export trade. Accordingly, consistent with our obligation under the Act and the antitrust laws generally to protect American consumers, we endeavor to process applications with a minimum of delay. Moreover, the Department stands ready to facilitate American industry's ability to compete internationally--the antitrust laws should not be improperly interpreted to impede this country's competitive efforts in international markets because it is vigorous competitive behavior that the antitrust laws are designed to promote.

Mr. Chairman, in summary, the Department of Justice's procedures to implement the Export Trading Company Act are in place and they are functioning well. We have encountered no significant obstacle or problem in implementing the Act, and we will continue our efforts to fulfill effectively and efficiently our responsibilities under it.

Mr. Chairman, that completes my prepared remarks. I would be pleased to respond to any questions you or the Subcommittee members may have.

Thank you.

BEST COPY AVAILABLE

Mr. BONKER. Mr. Rule, I think that the best thing that can be said about the Justice Department is that nobody is complaining. Indeed, it is great news that, according to your testimony no applications have been denied, no certificate to date has been challenged in court, the Department is endeavoring "to process applications with a minimum of delay," you "stand ready to help American industry to compete and * * * have encountered no significant obstacles or problems in implementing the act."

PREVIOUS JUSTICE DEPARTMENT RELUCTANCE

Earlier inhibitions about this legislation concerned the Justice Department's intransigence on the antitrust provisions. Indeed, much of the delay here in the Congress had to do with supporters of our antitrust laws, who felt that if we opened the doors a little bit on antitrust exemptions there would be all kinds of abuses.

I gather from what you have said today that there have been no abuses, and that those earlier concerns may have been exaggerated.

Mr. RULE. It is difficult for me to speak, and I certainly would not want to contradict what any of my predecessors said, but I do not think that there have been any abuses that we have seen yet. It is the law of the land, and we definitely support the purposes which underlie the act. And we have made a commitment, a very strong commitment, both to the Department of Commerce and to applicants, that we will proceed with all due alacrity in processing those applications and fulfilling our duty.

Mr. BONKER. I participated in many of the first seminars that were organized on ETC's, and there were always two different programs. One concerned the Federal Reserve Board and the title on bank participation, and the other focused on antitrust. The lawyers had mounds of information on the antitrust provisions, as though the antitrust exemption was going to be the big formidable problem with establishing ETC's. Somehow it seems to have been reduced now to a very minimum procedure. Is this just the nature of the profession?

Mr. RULE. Well, we are lawyers. We have gone through this at the Department recently with the joint R&D legislation, and I am working hard on that. There is always a concern that an antitrust lawyer or any lawyer can see, because I suppose that that is his upbringing—we are taught to sort of spot potential trouble. And there are potential dangers that can arise from export trading activity when it has an adverse effect on domestic trade.

What we have always said, and still believe, is that the antitrust laws in and of themselves are not an obstacle to a great deal of export trading activity. And we are not really surprised that a great deal of the conduct for which applications for certificates have been made does not violate the antitrust laws, because we did not think that a great deal of the export activity that people were talking about would have violated the antitrust laws.

Our only concern has always been that that activity not harm consumers. And I think that because the way the act was written, it does a very good job of protecting those interests while at the same time promoting export trade.

BEST COPY AVAILABLE

Mr. BONKER. Our earlier fears may have been misplaced. We probably should have been more concerned about the Fed and less concerned about the Justice Department role.

LIABILITY UNDER FOREIGN ANTITRUST LAWS

You made the statement that, "An export trade certificate of review does not protect U.S. companies from antitrust laws of other countries." Is that a potential problem?

Mr. RULE. Well, other countries certainly have competition laws. And there is a potential for some sort of liability.

Mr. BONKER. Japan has 8,000 trading companies. They go much further in providing and facilitating assistance than this law does; it just removes a few domestic prohibitions on the formation of ETC's. If Japan can get by with exporting virtually everywhere in the world without encountering difficulties with antitrust laws, why would we encounter any?

Mr. RULE. I guess that what I should stress is that that statement was not designed to raise a red flag and scare people, because as far as I know, foreign antitrust laws have not served as a great impediment to export trading. My purpose simply was to indicate the statutory reality, which is that there is no way that the statute could, and it certainly does not, extend protection or immunity from foreign laws. And to the extent that domestic companies are trying to export to a country that has a competition law, they simply need to be aware of that.

Mr. BONKER. Do you know of any country that has such a law?

Mr. RULE. Well, the EC countries have. In fact, the Japanese have a JFTC.

Mr. BONKER. What is a JFTC?

Mr. RULE. Japanese Fair Trade Commission. That is what we refer to as the JFTC. And other countries are formulating competition laws. So they are out there. And again, as I said, those laws tend to be fairly consistent with our own. And since the activities that we certify, and indeed most of the export trade activities, do not involve or may not involve, a violation of American laws, there may be reason to believe that in certain circumstances they do not violate foreign laws. However, it should be recognized that we cannot confer immunity from foreign trade laws, and people should be aware of that fact.

Mr. BONKER. My staff notes that most foreign laws are much less constraining than ours.

Mr. RULE. Some people have argued that the Japanese law is less restraining than ours. I am not sure that is necessarily so. The EC's laws are pretty strict. But again I want to stress that I am not here to say that, although we have got this immunity in the American antitrust law, forget it because you are really not protected and you are hanging out there by your thumbnails. I am just recognizing that we cannot confer immunity from foreign laws.

Mr. BONKER. Ms. Snowe.

Ms. SNOWE. Thank you, Mr. Chairman.

Mr. Rule, certainly it is a positive development that this antitrust immunity for certain export activity is working well. I think

BEST COPY AVAILABLE

that is encouraging. I just have several questions concerning the antitrust area.

MONITORING OF CERTIFICATE HOLDERS

Who does the monitoring to ensure that the companies comply with the standards set forth to allow them to receive the certificate of review?

Mr. RULE. Well, there is a provision that if we have reason to believe that the conduct engaged in no longer complies with those standards, then we have a right to go in. We have done that monitoring function. Of course, having at least a private cause of action, with the possibility of covering single damages, also creates some incentive on the part of potentially injured American companies and people in the United States to monitor the activities of those persons who have certificates. But we would monitor them where it seemed appropriate.

DURATION OF CERTIFICATES OF REVIEW

Ms. SNOWE. Are these certificates for a limited or an extended period of time?

Mr. RULE. So far they have not, as I understand it, generally been for limited periods of time. We can go in and revoke them if there is a problem. But so far, we have not generally required an automatic sunset provision.

Ms. SNOWE. So you do not specify 5 years or 2 years?

Mr. RULE. Not generally.

Ms. SNOWE. Not generally.

Do you have a general idea as to how long generally these companies would use a particular certificate?

Mr. RULE. That is a very difficult question, because we have such a short period of experience with them. And we do not know of any firms that have gone under or that have ceased to operate. It is just simply too early to know.

COOPERATION WITH DEPARTMENT OF COMMERCE

Ms. SNOWE. What about the statutory time frame for which you provide a certificate of review for a company in concert with the Department of Commerce? Has that worked well? Is that time frame adequate?

Mr. RULE. I think that it has worked well. Initially, we had to get down the learning curve like anyone else would have to. But I think over time, and given the number of applications for certificates that we have had to review, that we have developed a very good working relationship with the Department of Commerce. And we have managed to become a little more efficient and effective in the way that we review those applications. So as far as I see, there is no real reason to change the statutory period.

Ms. SNOWE. Do you rely on the information that is provided to you by the companies and the Department of Commerce? How do you go about ascertaining the information that requires you to make a decision on these certificates?

BEST COPY AVAILABLE

Mr. RULE. Well, we get the information from the Department of Commerce that initially receives the application, and it determines whether or not the information is complete. We can make a supplementary request for information and frequently do.

A lot of this, though, involves not only we and the Department of Commerce getting down the learning curve, but also people out in the private sector. And to the extent that applicants know what we are looking at, and what we want to know about the conduct that is involved, the information that we are getting is of a higher quality and more complete than it was perhaps in the initial phase of the implementation of the act.

Ms. SNOWE. Very good. I thank you for your testimony here today.

Thank you, Mr. Chairman.

### WEBB POMERENE ASSOCIATIONS

Mr. BONKER. Thank you, Ms. Snowe.

One last question. Are Webb Pomerene associations, applying pursuant to this title?

Mr. RULE. As far as I know, not really. I think that most applicants are applying under the Export Trading Company Act, although I can check on that. I can get you some information on that.

Mr. BONKER. Would you?

Mr. RULE. Sure.

Mr. BONKER. Because we want to keep the umbrella sufficiently large.

How many are there now?

Mr. RULE. Webb Pomerene associations?

Mr. BONKER. Yes.

Mr. RULE. That I do not know. I will find that out as well.

Mr. BONKER. Obviously, you do not spend a lot of time with them.

Mr. RULE. We do not spend a lot of time with Webb Pomerene associations.

Mr. BONKER. Thank you, Mr. Rule, for your testimony today.

Mr. RULE. Thank you.

Mr. BONKER. Keep up the good work.

Mr. RULE. We will try.

Mr. BONKER. We shall now hear from the chief administrative officer of Citibank's International Trading Co., Arthur Sultan. Mr. Sultan, proceed to the witness table and tell us about your woes with the Fed.

### DIFFICULTIES FACED BY ETC'S

Mr. SULTAN. Well, it is not just the Fed. It is a tough world out there. Before we get into the formal thing, to try to help make our point, we did not plant the following story in the Washington Post this morning. It says that "Sears World Trade Starts Big Cut-Back." They are cutting back 100 to 150 people off their staff. But it gives the feeling that folks like this who dedicated, if you say 100 to 150 people is 10 percent of 1000 to 1500, and they made a fairly significant commitment, and went out and bought quite a number

BEST COPY AVAILABLE

of companies, and put on some pretty high priced talent. And if you believe the woes that they had in the article in Fortune magazine, what seems to have occurred is that they found that it was a pretty tough world out there. And they really did not have the problem of the legislative or the Fed constraint.

Mr. BONKER. I know that they are a huge supplier and that they have distribution outlets everywhere, but I always thought that Sears went much too fast in too grandiose a way. If we want Sears to testify, will there be anyone left in their office? [Laughter.]

Mr. SULTAN. I guess your first question to them will be whether or not they have a resume out, to see how meaningful their comments are.

Mr. BONKER. Well, I will be anxious to hear from them, but Sears has never been a good example of what we had in mind when we passed this law.

Mr. SULTAN. But they could have really existed without this law.

Mr. BONKER. Yes, they could. There is nothing in this law that Sears needed or even utilized in the formation of its ETC. No, I take that back. With respect to the merger with the Chicago bank——

Mr. SULTAN. They did a joint venture.

Mr. BONKER. But that came after they formed the ETC.

Mr. SULTAN. Right. And my understanding or it was 6 months ago when I had a chat with somebody from Chicago is that they had put no business through that particular subsidiary.

Mr. BONKER. Did the bank then proceed to get certifications from the Fed?

Mr. SULTAN. My attorney will stop me if I am wrong, but I understand that the Sears/First Chicago joint venture is a subsidiary of the First Chicago's trading company. Their investment is as a wholly owned sub, and therefore in some way or another insulated.

Mr. BONKER. Well, it will be interesting to hear from them. When Sears formed their ETC, however, they did not have to come to the Commerce Department for a certification. Neither does Control Data, nor Rockwell, nor any of the other big companies that are forming the ETC's.

Let's hear about your experience.

Mr. SULTAN. What I would like to do, and excuse me, this is the first time that I have ever testified in front of a congressional committee, and I am not very much aware of the protocol, we have given you a written statement. I have gone through it and crossed out the stuff that probably bores you as much as it bores me.

Mr. BONKER. You have learned quickly.

Mr. SULTAN. Well, we try to. There is probably not a lot of difference between a private bureaucracy and a public bureaucracy.

What I would like to share with you today is the stuff that concerns us the most, and the reasons why we think that we have a lot of problems out there. And within the course of our remarks, we had a transaction that closed yesterday that I will share with you that is probably the most exciting thing that we have done so far.

Mr. BONKER. OK.

BEST COPY AVAILABLE

## STATEMENT OF ARTHUR P. SULTAN, CHIEF ADMINISTRATIVE OFFICER, CITICORP INTERNATIONAL TRADING CO. INC.

Mr. SULTAN. Mr. Chairman and members of the committee, I am Arthur Sultan. I am chief administrative officer of Citicorp's International Trading Co. As I said, we submitted our testimony in full, and we would like to share our primary thoughts with you.

In October 1982, the Export Trading Company Act became law. Title II of this statute, the Bank Export Services Act, amended the Bank Holding Company Act to permit bank holding company ownership of export trading companies, as within the limited definition of the Act.

Citicorp acted to obtain this authority, and by letter dated May 31, 1983, the Federal Reserve Board informed Citicorp that it would not disapprove of Citicorp's notice to establish a wholly owned export trading company.

We are pleased to have the opportunity to share with this committee our experience with and plans for Citicorp International Trading Co. as well as some of the conclusions as to possible policy implications which might be drawn from our experience.

### EXPORT TRADING COMPANY ACT AS RESPONSE TO TRADE DEFICIT

The impetus for the 1982 legislation was a desire on the part of Congress we believe to address the worsening United States trade deficit. During the 1970's the United States export volume had increased dramatically, with total volume growing over twice as rapidly as total world trade.

However, during the latter part of the decade of the 1970's, the United States went from a trade surplus of $9 billion in 1975 to a deficit of over $24 billion in 1980. At the time of the passage of the statute, the United States was on its way to another annual trade deficit in excess of $30 billion.

Ironically, since the Export Trading Act of 1982 became the law of the land, the situation has not only deteriorated, but gives the impression of an accelerating downward spiral. Without belaboring the statistical analysis, the U.S. Department of Commerce now reports that as of May 1982, the trade deficits stands at an annualized rate of $107 billion. This figure is more than three times the 1982 deficit.

Mr. BONKER. Secretary Baldrige says that it is going to go up to $140 billion.

Mr. SULTAN. If you want a substantiation of what I am saying, I appreciate the Secretary's support.

Based on all of our sources of information, it seems that the Export Trading Company Act of 1982 had not done much to solve the problem. Perhaps this dark economic picture will prompt a reassessment.

Mr. BONKER. I hate to disagree with you, Mr. Sultan, but I think that the trade deficit is a product of increased imports rather than decreased exports.

Mr. SULTAN. We think that it is a little bit of each. Imports are a function of an inefficiency in the U.S. marketplace.

Mr. BONKER. They are both a function of the overvalued dollar.

BEST COPY AVAILABLE

Mr. SULTAN. I will give you an example. And I will come back to the text in a minute, if I may. Take the machine tool manufacturer in Cincinnati. And we made a point of calling on a number of them, because we thought that was a product that we could sell.

And we found that the smaller manufacturers, the job shops that had 50, 100, 150 people, have sold perhaps as much as 1,000 miles away from their own plant. And they have one or two salesmen outside of their engineers that go out and try to sell whatever particular machine tool or die that they are trying to sell.

We would go to them and say, hey, we would like to shoot at trying to help you sell your goods outside of the United States. And the first reaction is, Why should I use you? And the second question, or maybe it should have been the first, is, What the hell is a trading company? And the third is I am not really very much interested in selling to them "foreigners," can you help me sell something in San Francisco or something in New York?

And the answer is "No." Under both the statute and the regs, we are not allowed to help them increase their sales. So what you see, and just focusing on this industry, is that you see the Japanese coming into San Francisco, and Los Angeles, and your home State of Washington, and you see the Germans, and the Swedes, and the Finns bringing their machine tools into the east coast. And where there is probably as much expertise within the United States, the sales pattern is not such that we are even effectively competing in our home market.

I agree with your point that the strong dollar hurts a lot. The thing that also hurts a lot is that we have an inefficient distribution network within this country for the very fine products that we make.

### ASSESSMENT OF THE BANK EXPORT SERVICES ACT

Perhaps this dark economic picture will prompt a reassessment. If the Bank Export Services Act has had no demonstrable affirmative effect on the U.S. trade picture, why is that? Were the assumptions underlying the statute mistaken? Are the statute and the Federal Reserve Board regulations too restrictive? Has bank management failed to recognize opportunity? Or is it simply too soon to tell?

Answering the last question first, we do not feel that it is too early to draw some lessons from our experience to date. Were the assumptions underlying the statute mistaken? Of course not. The idea behind the Bank Export Services Act is sound, but bank holding companies will not fix world trade problems singlehandedly.

Are the statute and the Federal Reserve Board regulations too restrictive? Yes. We feel with adequate latitude to perform activities comparable to other international trading houses along with flexible financing by their bank holding company parents, these organizations can make a contribution to U.S. exports.

We also believe that export trading company activities can be conformed to legitimate safety and soundness concerns by limits on investments in those concerns rather than narrow definitions of their activities. I will make some suggestions on liberalized scope for export trading company activities a bit later.

BEST COPY AVAILABLE

Has bank management failed to recognize opportunity? No. There are 28 bank holding companies who have failed for and have been granted charters to own and operate export trading companies. However, only 14 of the 28 were affiliated with the banks listed in the top 100. This might be ascribed to either a lack of conformance with the strategic plans of the big banks, or a perception that the statute and regulations are too restrictive to allow them to compete effectively in the global marketplace.

If I may, I would like to describe the present status and resources of Citicorp International Trading Co., Inc., or in the interest of brevity CITC, and some of the business that we have conducted successfully to date.

CITICORP INTERNATIONAL TRADING COMPANY

CITC has 60 full-time personnel dedicated to its efforts. They are located in offices in three U.S. cities, two South American countries, three Asian countries, and the United Kingdom. We have hired eight senior traders with diverse disciplines, and have liberally supported them with some of the most entrepreneurial bankers within Citibank.

Citicorp's global network of over 2,000 offices in 94 countries can also be utilized by CITC, permitting access to the Citicorp/Citibank customer relationships.

As to some of the activities that we are involved in, the first would be nonrecourse trade finance. This activity consists of the purchase, usually from U.S. exporters, of promissory notes signed by foreign importers. This trade paper is generated to finance an international trade transaction, and its purchase by our trading company usually finances the exporter.

All such transactions facilitate international trade. And where a U.S. exporter is involved, the effect is to facilitate U.S. exports. CITC has purchased such receivables from U.S exporters in several instances. These debts became the obligation of the foreign central banks after they had received local currency payment from importers.

All such receivables have been successfully collected to date. Citicorp has found that this nonrecourse trade finance activity, which draws on our existing bank lending skills, can help us build a revenue base.

The second category is purchase and sale financing. And please, if this is more our jargon than yours, stop me and ask me. Because it took me awhile to learn it, too, when we first started it.

Mr. BONKER. As long as we avoid congressional jargon.

Mr. SULTAN. OK. Purchase and sale financing. I have invented this awkward description for the variety of transactions in which CITC uses its power to take title as a finance equivalent. In such situations, we are dealing with a purchase and sale which our customer, usually the seller, will arrange.

However, the seller typically will want immediate cash payment. The purchaser, of course, wants credit terms. CITC buys from the seller and sells to the purchaser for later payment on delivery or on credit terms.

BEST COPY AVAILABLE

What is unique in this and is different from bank lending and is a lot different from what Mr. Draper was talking about----

Mr. BONKER. You mean that you hold inventory?

Mr. SULTAN. Yes, but we hold inventory—well, let me go back, and we will cover it probably in more detail later. The statute allows us to hold inventory. We have as a matter of policy, our own internal policy, not your statute or the Fed's regulations, not yet decided to take open positions that are any larger than an eye blink.

If we hold goods in a case like this. Let's say we will take the same machine tool guy, and we are shipping something to Brazil, we will pay him up front. The guy buying in Brazil will have a prime international bank issue a letter of credit in our favor. So although the goods may in fact be on our book, we are covered by a letter of credit. We are also covered by cargo insurance on the boat. And if it is a perishable commodity, we are also covered by product quality insurance.

So it is not open. We have not yet done open for a number of reasons. And we will get into some of those a bit later, if we may.

COUNTERTRADE

Countertrade services. So-called countertrade is a production of the overall illiquidity problems. While the Eastern European countries have been using it for many years, its recent worldwide growth is largely a result of the well-publicized lack of liquidity being experienced by some Latin American, African, and Asian nations.

The term "countertrade" or "reciprocal trade" refers to practices which mandate that imports can only be permitted in a country where the importer commits to create export transactions. These transactions are created to offset hard currency lost through the import.

Methods and terms vary. And as a practical matter, it is usually the exporter seeking to sell goods to the importing country who ultimately bears the burden of solving the countertrade equation.

CITC's role in a countertrade transaction might be acting as finder in attempting to locate a buyer for the countertrade goods or offering to buy them itself. In the latter case, CITC would already have located a buyer to whom it could resell.

An example of this activity would be a transaction which CITC completed at 4:30 yesterday afternoon under which it satisfied the countertrade obligation imposed on a U.S. manufacturer who is shipping equipment to the Dominican Republic by taking delivery of a significant tonnage of sugar. CITC then pays the U.S. exporter cash from the proceeds of the sale.

It was the first successful transaction of this nature completed in the Dominican Republic. As a matter of fact, the government felt that it was important enough that their president announced it on their television channels last evening.

Mr. BONKER. Let me ask you a question. Your trading company paid the U.S. exporter in cash from the proceeds of the resale of sugar.

Mr. SULTAN. Right.

BEST COPY AVAILABLE

Mr. BONKER. So you took the commodity from the American exporter, or at least the American supplier, but you did not pay him until after you sold the commodity to the Dominican Republic.

Mr. SULTAN. No, no. The U.S. exporter sold his goods to the Dominican Republic. The Dominican Republic offered to give him goods. We specified that the most saleable Dominican good would be sugar. We were acting in two roles in this.

Mr. BONKER. What was the exportable product?

Mr. SULTAN. Trucks?

Mr. BONKER. Sugar for trucks?

Mr. SULTAN. Yes.

Mr. BONKER. So the American exporter was providing the trucks.

Mr. SULTAN. Right.

Mr. BONKER. The Dominican Republic has a lack of cash. So they were offering sugar in exchange?

Mr. SULTAN. Right.

Mr. BONKER. And you were handling this in a countertrade situation?

Mr. SULTAN. Yes, sir.

Mr. BONKER. Who did you sell the sugar to?

Mr. SULTAN. We sold some into the commodity markets, and we sold some to a sugar trading company.

Mr. BONKER. So you took the proceeds from that sale of sugar, and then paid the American exporter?

Mr. SULTAN. Right.

Mr. BONKER. Was this deal all consummated before you entered into it?

Mr. SULTAN. No, it had taken three of our people the last 8 weeks on a full-time basis.

Mr. BONKER. What would you have done if you were not able to sell the sugar?

Mr. SULTAN. The contract that we entered into was on a best efforts basis. There was no alternative for the exporter.

Mr. BONKER. So the exporter had to wait until after you completed that transaction before they got their money?

Mr. SULTAN. In the nature of any trading company. And we do not always say this publicly. But we are not going to take a commitment to do something unless we have a buyer. We are not going to sit with a giant warehouse of $x$ million dollars' worth of sugar, if we can avoid it.

Mr. BONKER. Do you do a lot of countertrade?

Mr. SULTAN. This is the fifth transaction that we have done. Primarily, we have been doing them out of Indonesia. We have a number out of Indonesia. Our perception is, and we are very small compared to many of the established trading houses, is that there is probably a great deal more discussion of countertrade than there is actual countertrade that takes place. And it becomes increasingly difficult.

Each country has a program, and each country that has a program seems to change the rules when you get close to consummating a transaction.

Mr. BONKER. I always wondered how many bananas it would take to buy an American-made truck.

BEST COPY AVAILABLE

Mr. SULTAN. How big a truck, and how much do you want to pay for the bananas?

SUGGESTIONS FOR IMPROVEMENT OF BANK EXPORT SERVICES ACT

In reviewing our experience with these activities and our view of potential activities, we have several thoughts which we would appreciate the opportunity of sharing with you.

First, I will point out some areas where I feel greater statutory and/or regulatory latitude will help fulfill the role which Congress appears to have had in mind. However, I wish to emphasize that Citicorp remains ever mindful of the very legitimate and important concern that export trading company activities must not threaten the safety and soundness of the bank holding company. However, we believe that this concern is adequately satisfied by the limit on the commitment of the holding company capital found in the statute.

These limits restrict Citicorp's equity contribution to 5 percent of Citicorp's consolidated capital. No matter how liberal the view of export tradin company powers, the likelihood of losing all of this contributed capital is very small. Awareness that we are in a risk assuming business is part of the Citicorp culture, and we pay careful attention to risk management.

In practice, we are likely to have invested less than 5 percent maximum, leaving room in the worst case analysis to cover losses in excess of the existing equity. However, if one assumed the worst case, that is if Citicorp lost 5 percent of its capital, which would be the permitted limit, this loss could be absorbed. Because 5 percent of Citicorp's capital is three-tenths of 1 percent of Citicorp's overall assets.

Now you are talking about a $140 billion entity. And in this case, we are talking about having an equity base of a maximum of $350 million.

Reviewing the lines of business mentioned, I will explain where liberalization will help. Financing the trading company. I mentioned trading as well as nonrecourse trade finance and how they can facilitate U.S. exporters.

Clearly, a trading and financing business is more profitable if an attractive source of funds is easily accessible. Yet the exemption to the restrictions of section 23(A) of the Federal Reserve Act was eliminated by the Federal Reserve in its regulations due to intervening statutory amendments to section 23(A).

It is hard to square restrictions on financing of trading companies with the stated intention of the law to "draw on the resources of the United States banking system."

Like other trading companies competing in the international arena, CITC may need to take positions in goods or commodities. Position taking connotes an open trade in which a company owns or is obligated to purchase a commodity, but has not yet obtained a purchaser for all or part of a commodity.

If the company eventually takes delivery, the position may also be referred to as inventory. And this is the key to our argument, and I would like to really emphasize it. The capacity and willingness to take a position is a necessary aspect of an effective trading

BEST COPY AVAILABLE

company. It is a perfectly prudent practice when conducted within the parameters of established risk management procedures and limits.

Such positions do not represent blind speculation on price changes, but rather acting to take advantage of unusual price opportunities. For example, the countertrade requirements are usually imposed to move goods which a country cannot readily sell for cash. Thus someone willing to take a position in such goods might obtain considerable discounts. The mere willingness to provide scarce cash for oversupplied and/or lower quality product adds value.

The Federal Reserve Board in its testimony before this committee indicated that it delegates authority to Reserve Banks to act upon export trading company notification, only among other things where the company would "take title to goods only against firm orders, except that the company may maintain an inventory of up to $2 million."

The Federal Reserve Board clearly has not said that they will so limit all notices they receive. We hope that the guideline does not reflect an assumption that back to back transactions are the norm, and that position taking must be limited by an absolute standard which in this case does not relate to the size, or turnover, or volume of business.

We would hope that the regulatory policy could be to give significant latitude to export trading companies, and only to disapprove those activities or risk management policies which involve unsafe or unsound practices.

In our view, the type of position taken described above must be permitted if the stated congressional purpose of creating viable and effective international trading entities is to be fulfilled.

If Congress intended the export trading companies to go beyond the role of financing trade and to engage in trade as a part of the normal flow of business, it is a difficult task to compete with one hand tied behind your back.

The statute requires that an export trading company be exclusively engaged in activities related to international trade. This requirement was apparently intended to keep the trading company from using new powers domestically. Unfortunately in our view, this restriction is counterproductive. It is difficult to work with a customer, yet restrict one's services solely to international transactions.

While Congress specified the objective of assisting small businesses in exporting, it may have failed to consider that a bank holding company may be unable to cover its fixed costs in developing business by only financing and/or servicing incremental export production of small companies.

We believe that the statute should permit services in any phase of domestic business that has an effect on finished product that is competing in the United States or abroad against foreign producers.

While the stated intent of the Export Trading Company Act of 1982 is to encourage U.S. exports, the role of helping maintain market share in the United State against foreign products should be permissible to our export trading companies.

BEST COPY AVAILABLE

This is indeed the case with the "sogo shosha," the Japanese trading companies. Today, they use their international expertise to source, finance, inform, develop, and secure their domestic markets, and finally to export from them.

One point which has already received some attention from this committee, but which I would like to restate, is the application of the 50-percent test in the Federal Reserve Board regulations. Where a U.S. export transaction is generated by completing a countertrade, the regulations require that revenues from the latter transaction be counted as an offset to revenues from the U.S. export transaction.

An export trading company anxious to meet the 50-percent test might forego the transaction which if the countertrade fee were large would work against its satisfying the test. Yet the underlying deal clearly works to improve the U.S balance of trade.

I would argue that satisfying the countertrade obligations imposed the U.S. firms should always be included as facilitating U.S. exports. The Dominican transaction which I mentioned earlier will be counted against us under the current rules, although it is vividly clear that the U.S. export would not have occurred without the countertrade portion.

Mr. BONKER. You were here a few weeks ago when we went around and around with the Fed on this.

Mr. SULTAN. You made a very good point. They need to change that. There are two things they need to change. The first one that is so silly—my crew is going to yell at me for using words like that, but that is OK—is that trade between third countries, that is, we would sell coal from Australia to Indonesia, which has nothing to do with the United States, but goes a long way to cover our cost basis, 60 people, international bankers and traders, earn significantly more than $3.25 an hour. It should not count against us, it should not count for us, it should not count period. That is point one.

Point two, on this Dominican transaction, and it will be announced, Mack Trucks would not have sold *x* million dollars' worth of trucks to the Dominican Republic if we had not been able to move the sugar in return. Yet me made our fee from moving the sugar, and that will be counted against us in the 51-percent transaction.

If we do that too often, you know, they will come in at their audit period, and say, hey, you guys are in violation of our rules, why don't you give us back your license. We do not want to do that. We want to help.

We believe in this a lot. I mean we have dedicated 60 people to it. We have dedicated some of the best people we have internally. We frankly want to have a lot of fun with it. It is new. Banking itself is OK. But getting involved in goods, and getting involved with it slowly, and carefully, and prudently is a lot more important.

And we are sitting there with this commitment of these people being the world's largest financial institution saying to anybody who will listen to us that we are going to make a success of this if we possibly can. And we are sitting there with our hands like this. There is nothing more frustrating.

BEST COPY AVAILABLE

I run the administrative corps. And if I am a good person, every so often I get to feed customers. And to have a good transactor come in, who has worked out a wonderful deal, and to sit there and tell the guy, I am sorry, you cannot do it, because it is either in violation of the statute or it is in violation of the regulations that the Federal Reserve Board has put forth.

NEED FOR CAUTION

Mr. BONKER. Well, on the other hand, given some of the banks' reputation over the past 10 or 12 years on loans——

Mr. SULTAN. Our bank?

Mr. BONKER. I do not know specifically about your bank, but there were many examples of unwise loans, primarily to Latin American countries. There was need for a tightening of the rules. Everybody admits now that many of the loans were not provided on the basis of prudent, careful analysis. There is room to fault the Federal Reserve Board, but this is a whole new dimension for the financial community of getting into commercial transactions.

I do think that we ought to move cautiously—not in a way that inhibits our trade activity, but in a way that does not unnecessarily jeopardize investor deposits in banks to carry out certain commercial activities.

Mr. SULTAN. May I share something with you, because the argument that you make is very much the argument that I get from my seniors. Let me give you the analogy that we try to draw. If I take a small- to medium-size company, and I make a loan to them of $10 million. That is unsecured other than the fact that they have an earning record and they have a good name. I take a risk of not getting paid back for that loan.

If I buy 10 million dollars' worth of steel, and I put it on a boat, and the boat sinks, my risk is zero. Because I have insured the boat. I have insured if it is a perishable commodity for product quality. And if the boat gets stuck in some harbor where I have to pay demurrage, I have paid for the insurance on demurrage. And the maximum movement of the price of steel in any given month is 3 percent.

It is a less risky business than lending money. We truly believe that.

Mr. BONKER. Well, possibly, but it is still a whole new venture for banks, and people are reticent to give you full rein. We will just have to move in stages. In any case, countertrade is something that ought to be dealt with more realistically than the Fed is presently allowing.

Mr. SULTAN. Thank you.

[Mr. Sultan's prepared statement follows:]

BEST COPY AVAILABLE

PREPARED STATEMENT OF ARTHUR P. SULTAN, CHIEF ADMINISTRATIVE OFFICER, CITICORP INTERNATIONAL TRADING CO., INC.

Mr. Chairman and members of the Committee, I am Arthur P. Sultan, Chief Administrative Officer of Citicorp International Trading Company, Inc.

Background of Bank Export Services Act ("BESA")

In October of 1982 the Export Trading Company Act of 1982 became law. Title II of this statute, the Bank Export Services Act, amended the Bank Holding Company Act to permit bank holding company ownership of export trading companies, as within the limited definition of the Act.

Citicorp acted to obtain this authority, and by letter dated May 31, 1983, the Federal Reserve Board informed Citicorp that it would not disapprove Citicorp's notice filed pursuant to the Bank Holding Company Act (as amended by the Export Trading Company Act of 1982), to establish a wholly-owned export trading company. [1] Citicorp is pleased to have the opportunity to share with this Committee our experiences with, and plans for, Citicorp International Trading Company, Inc. as well as some conclusions as to possible policy implications which might be drawn from our experience.

The impetus for the 1982 legislation was a desire on the part of Congress to address the worsening United States' trade deficits. During the 1970s, the United States' export volume had increased dramatically, with total volume growing over twice as rapidly as total world trade. However during the latter part of the decade of the 1970s, the U.S. went from a trade surplus of 9 billion dollars (1975) to a deficit of over 24 billion dollars (1980) at FAS values. At the time of passage of the statute, the U.S. was on its way to another annual trade deficit in excess of $30 billion.

Ironically, since the Export Trading Company Act of 1982 became the law of the land, the situation has not only deteriorated, but gives the impression of an accelerating downward spiral. Without belaboring the statistical analysis, the U.S. Department of Commerce now reports that as of May 1984

1. It has been our experience, incidentally, that Federal Reserve staff have handled all of our export trading company questions and filings in an expeditious way.

BEST COPY AVAILABLE

the trade deficit stands at an annualized rate of 107 billion dollars. This figure is more than three times as large as the 1982 trade deficit of $31 billion.

Based on all our sources of information, it seems the Export Trading Company Act of 1982 has not done much to solve the problem! In fact, if one accepts the tone of a recent Wall Street Journal article reporting on bank-affiliated export trading companies, one might think there is little hope.

Perhaps this dark economic picture will prompt a reassessment. If the Bank Export Services Act has had no demonstrable affirmative effect on the U.S. trade picture, why is that? Were the assumptions underlying the statute mistaken? Are the statute, and the Federal Reserve Board regulations too restrictive? Has bank management failed to recognize opportunity? Or, is it simply too soon to tell?

Answering the last question first, we do not feel it is too early to draw some lessons from experience to date.

- Were the assumptions underlying the statute mistaken?
The idea behind the Bank Export Services Act is sound but bank holding companies will not fix world trade problems single handedly.

- Are the statute and Federal Reserve Board regulations too restrictive?
With adequate latitude to perform activities comparable to other international trading houses, and to permit flexible financing by their bank holding company parents, these organizations can make a contribution to U.S. exports; and export trading company activities can be conformed to legitimate safety and soundness concerns by limits on overall holding company investments in these concerns rather than narrow definitions of their activities. I

BEST COPY AVAILABLE

will make some suggestions on liberalized scope for export trading company activities a bit later.

- Has bank management failed to recognize opportunity?

Twenty eight bank holding companies have filed for and have been granted charters to own and operate export trading companies. Only 14 of these 28 bank holding company affiliated ETCs were affiliated with banks listed among the top 100 in the U.S. This might be ascribed to lack of conformance with the strategic plan and resources of the "big banks", or a perception that the statute and regulations are too restrictive to allow them to compete effectively in the global marketplace.

Resources and Activities of Citicorp International Trading Company, Inc.

If I may, in the interest of presenting the experience of one export trading company organized under BESA, I would like to describe the present status of resources of Citicorp International Trading Company, Inc. (or, in the interest of brevity, "CITC") and some of the business conducted to date by CITC.

Resources

CITC has sixty full time personnel dedicated to its efforts. They are located in offices in three U.S. cities, two South American countries, three Asian countries and The United Kingdom. We have hired eight senior traders with diverse disciplines and have liberally supported them with some of the most entrepreneurial bankers within Citibank. Citicorp's global network of over 2000 offices in 94 countries can also be utilized by CITC, permitting access to the Citicorp/Citibank customer relationships as an additional resource to provide efficient market channels.

BEST COPY AVAILABLE

## Current Activities

A. Non-Recourse Trade Finance

This activity consists of the purchase, usually from U.S. exporters, of promissory notes signed by foreign importers. This "trade paper" is generated to finance an international trade transaction, and its purchase by our trading company finances the exporter. All such transactions facilitate international trade and, where a U.S. exporter is involved, the effect is to facilitate U.S. exports. CITC has purchased such receivables from U.S. exporters in several instances. These debts became the obligation of foreign central banks after they received local currency payment from importers. All such receivables have been successfully collected to date. Citicorp has found that this non-recourse trade finance activity, which draws on existing bank lending skills, can build a revenue base for CITC.

B. Purchase and Sale "Financing"

I have invented this awkward description for the variety of transactions in which CITC uses its power to take title as a finance equivalent. In such situations we are dealing with a purchase and sale which our customer, usually the seller, will arrange. However, the seller typically will want immediate cash payment. The purchaser wants credit terms, or may want to pay only on physical delivery at some point in the future. CITC buys from the seller and sells to the purchaser for later payment on delivery or on credit terms. An example of this would be CITC's purchase of a cargo of bananas from an Ecuadorian exporter and resale of the cargo to an American importer. The deal involved complications, but essentially included extending credit terms to the U.S. importer.

C. Countertrade Services

So-called countertrade is a product of overall illiquidity problems. While the Eastern European countries have been using it for many years, its recent

BEST COPY AVAILABLE

worldwide growth is largely a result of the well-publicized lack of liquidity being experienced by some Latin American, African, and Asian nations. The negative impact of this latter problem on the U.S. balance of trade is detailed in a Wall Street Journal article dated May 8, 1984. One of the possible answers to a nation's lack of hard currency is barter transactions: trading goods for goods without cash (or with only minor cash adjustments). However, such transactions require a precise correlation of mutual interests and so are few and far between today. More commonly, recourse is had to barter's first cousin, countertrade.

The term countertrade (or reciprocal trade) refers to practices which mandate that imports can only be permitted in a country where the importer commits to create export transactions which offset hard currency lost through the import transaction. Methods and terms vary and, as a practical matter it is usually the exporter seeking to sell goods to the importing country, who ultimately bears the burden of solving the countertrade equation.

CITC's role in a countertrade transaction might be acting as finder in attempting to locate a buyer for the countertrade goods or offering to buy them itself. In the latter case, CITC would already have located a buyer to whom it could resell. An example of this activity would be a transaction which CITC is currently involved in, under which it satisfies the countertrade obligation imposed on a U.S. manufacturer who is shipping equipment to the Dominican Republic by taking delivery of a significant tonnage of sugar. CITC then pays the U.S. exporter cash from the proceeds of CITC's resale of the sugar.

Evaluation

In reviewing our experience with these activities and our view of potential

BEST COPY AVAILABLE

activities, I have several thoughts which I would appreciate the opportunity of sharing with you.

First, I will point out some areas where I feel greater statutory and/or regulatory latitude will greatly help bank-affiliated export trading companies fulfill the role which Congress appears to have had in mind. However, I wish to emphasize that Citicorp remains mindful of the very legitimate and important concern that export trading company activities must not threaten the safety and soundness of the bank holding company. We believe that this concern is adequately satisfied by the limit on the commitment of holding company capital found in the statute.

These limits restrict Citicorp's equity contribution to five percent of Citicorp's consolidated capital. No matter how liberal the view of export trading company powers, the likelihood of losing all of this contributed capital is small. Awareness that we are in a risk-assuming business is part of the Citicorp culture, and we pay careful attention to risk management. In practice, we are likely to have invested less than the five percent maximum, leaving room in a worst case analysis, to cover losses in excess of the existing equity. At present Citicorp's equity contribution to CITC is equivalent to six one-hundreths of one percent of Citicorp's primary capital. However, if one assumed the worst case, that Citicorp lost all of the permitted limit, this loss could easily be absorbed. Five percent of Citicorp's capital is three tenths of one percent of Citicorp's overall assets.

Reviewing the lines of business mentioned, I will explain where liberalization will help.

Financing the Export Trading Company

I mentioned trading as well as non-recourse trade finance and how they can

BEST COPY AVAILABLE

facilitate U.S. exports. Obviously a trading and financing business is more profitable if an attractive source of funds is easily accessible. Yet the exemption to the restrictions of Section 23A of the Federal Reserve Act, which we believe was intended by Congress, was eliminated by the Federal Reserve in its regulations due to intervening statutory amendments to Section 23A. It is hard to square restrictions on financing of trading companies with the stated intention of the law to "draw on the resources ... of the United States banking system".

Export Trading Company Position Taking

Like other trading companies competing in the international arena, CITC may need to take positions in goods or commodities. Position taking connotes an open trade in which a company owns or is obligated to purchase a commodity, but has not yet obtained a purchaser for all or part of a commodity. If the company eventually takes delivery, the "position", may also be referred to as an "inventory". The capacity and willingness to take a position is a necessary aspect of an effective trading company. It is a perfectly prudent practice when conducted within the parameters of established risk management procedures and limits. Such positions do not represent blind speculation on price changes, but rather acting to take advantage of unusual price opportunities. For example, the countertrade requirements are usually imposed to move goods which a country cannot readily sell for cash. Thus someone willing to take a position in such goods might obtain considerable discounts. The mere willingness to provide scarce cash for oversupplied and/or lower quality products, therefore adds value.

The Federal Reserve Board, in its testimony before this committee indicated

BEST COPY AVAILABLE

that it delegates authority to Reserve Banks to act upon export trading company notifications only, among other things, where the company would "take title to goods only against firm orders, except that the company may maintain an inventory of up to $2 million". The Federal Reserve clearly has not said that they will so limit all notices they receive. We hope that the guideline does not reflect an assumption that back-to-back transactions are the "norm" and that position taking must be limited by an absolute standard which in this case does not relate to size or turnover volume of the business. We would hope that the regulatory policy could be to give significant latitude to export trading companies and to disapprove only those activities or risk management policies which involve unsafe and unsound practices.

In our view, the type of position-taking described above must be permitted if the stated Congressional purpose of creating viable and effective international trading entities is to be fulfilled. If Congress intended the export trading companies to go beyond the role of financing trade and to engage in trade as a part of the normal flow of business, it is a difficult environment in which to compete with one hand tied behind you. Creating a trading entity which lacks the flexibility to take positions as consistent with prudent management would seriously limit its potential.

Activities Related to International Trade

The statute requires that an export trading company be exclusively engaged in activities related to international trade. This requirement was apparently intended to keep the trading companies from using new powers domestically. Unfortunately, in our view, this restriction is counter-productive. It is difficult to work with a customer, yet restrict one's services solely to

BEST COPY AVAILABLE

international transactions. While Congress specified the objective of assisting smaller businesses in exporting, it may have failed to consider that a bank holding company may be unable to cover its fixed costs in developing business by only financing and/or servicing incremental export production of small companies.

Of course assisting the United States balance of trade is a necessary objective. Let's not forget, however, that a major market determining that balance is within the United States, itself, not overseas. In other words, U.S. domestic sales lost to imports have been of major significance in widening the U.S. trade deficit. In today's illiquid climate, the United States remains the largest and most unrestricted world market. Yet activities in this market are forbidden to the trading companies regardless of whether they would work to improve the United States' balance of trade.

Let me provide another example of a domestic, and presumably prohibited, transaction which would assist U.S. trade. A U.S. glass producer has 30 million dollars of platinum in the "pipeline", i.e. this is required for its glass-making process. We have a method of financing the platinum, which would reduce the company's need to tie up cash for the platinum and would reduce its borrowing cost. This method would involve purchasing the platinum and reselling it to this company at a future date. A portion, but not all of the glass produced by the company is exported. Domestically, the company is competing with imports of specific glass products. Our method of financing would help it compete in the export market as well as domestically against imports. This type of "pipeline financing" is typically performed by foreign investment banking firms, primarily in Europe.

BEST COPY AVAILABLE

We believe that the statute should permit services such as the above in any phase of domestic business that has an effect on a finished product that is competing in the U.S. or abroad against foreign producers; and services in a domestic phase of business of a company engaged in foreign trade. While the stated intent of the Export Trading Company Act of 1982 is to encourage U.S. exports, the role of helping maintain market share in the U.S. against foreign products should be permissible to our export trading companies. This is indeed the case with the successful SOGO SHOSHA, the Japanese trading companies. Today, they use their international expertise to source, finance, inform, develop and secure their domestic markets - and finally to export from them.

The Fifty Percent U.S. Export Requirement

One point which has already received some attention from this Committee, but which I would like to restate, is the application of the 50 percent test in the Federal Reserve Board regulations. Where a U.S. export transaction is generated by completing a countertrade from the importing country to a third party country, the regulations require that revenues from the latter transaction be counted as an offset to revenues from the U.S. export transaction. An export trading company anxious to meet the 50 percent test might forego the transaction which, if the countertrade fee were large, would work against its' satisfying the test. Yet the underlying deal clearly works to improve the U.S. balance of trade. I would argue that satisfying countertrade obligations imposed on U.S. firms should always be included as facilitating U.S. exports - even where the trading company was not responsible for making the export trade, itself. Within the same regulation is also the decision that trade created between third countries,

BEST COPY AVAILABLE

i.e., neither an import nor an export, would be counted "against" you in the 50% calculation.

Export of Services of Affiliated Companies

Finally, I would like to make a point in connection with the export of services from the United States. We have heard much discussion in recent times to the effect that the United States is becoming a "service economy". The service-derived portion of our Gross National Product has been steadily increasing. What is not so widely perceived is that United States surplus in service exports has been in decline for the past two years (the 1983 surplus of $6.5 billion compares with a 1982 surplus of $7.6 billion) and, as reported in a Business Week article of March 19, 1984, the U.S. faces effective new international competition in telecommunications, advertising, software, construction, real estate and other service markets. It is in this context that the regulations promulgated under the Bank Export Services Act, have barred a bank holding company from counting as U.S. export revenues, amounts made by the export of services of the trading company, itself, or a subsidiary. We believe that this result is neither required by the letter nor the spirit of the original legislation. We see no reason why the statutory purpose is not well served by permitting export trading companies to export their own services.

A Prediction

On the questions that I mentioned briefly earlier - "Has bank management failed to recognize the opportunity?" or "Is it too soon to tell?" I would suggest that most major commercial banks, who have not yet opted to participate in

BEST COPY AVAILABLE

this business will not choose to do so in the immediate future. The reason for this conclusion follows from what we have said -

1) The cost of entry is very high.

2) The legislative and administrative restrictions do not allow them adequate latitude to compete in what is clearly a fiercely competitive global market.

Summary

In the interest of economy of time, I have touched only briefly on some points which merit a serious examination. If I may, I would like to reiterate these major points.

Citicorp remains cognizant of important bank holding company safety and soundness concerns which must be of paramount concern to the Federal Reserve Board. We agree that restrictions on the amount of holding company capital committed to bank-affiliated export trading companies is required.

The present statute as coupled with current Federal Reserve Board regulations limits latitude to engage in trade services and, as restricted by cost of funds limitations, trade finance. In addition, many significant activities we associate with true export trading companies have been barred or impaired - to wit, positioning, countertrade, as well as export of the goods and services of affiliated entities.

Although one might argue, "half a loaf is better than none," the tough arena of international trade has been telling us that without the freedom to compete effectively we may come up empty handed.

A real trading company business takes time and effort to build, even under the best conditions. We ask that the legislature and our regulators give us flexibility, and we will do our best in this hostile international trade environment. Our European and Asian competitors have already made major inroads into markets and businesses where we could play a major role - given a realistic opportunity of using the same rules they do.

BEST COPY AVAILABLE

EXHIBITS

Exhibit I: U.S. News & World Report
April 9, 1984
"Now in Prospect: a $100 Billion Trade Gap"

Exhibit II: The Wall Street Journal
May 24, 1984
"Export Trading Firms in U.S. are Failing to Fulfill Promise"

Exhibit III: The Wall Street Journal
May 8, 1984
"Latin Debt Crunch Hurting U.S. Firms"

Exhibit IV: Business Week
March 19, 1984
"The Next Trade Crisis May Be Just Around the Corner"

BEST COPY AVAILABLE

EXHIBIT I

# Now in Prospect: A $100 Billion Trade Gap

As CONGRESS and President Reagan struggle to trim the government's huge budget deficits, the "other deficit"—the gap between U.S. imports and exports—is growing alarmingly.

Commerce Department figures released March 29 show that Americans' spending on foreign goods topped U.S. overseas sales by 19.6 billion dollars in the first two months of 1984. At that pace, the merchandise trade deficit is likely to exceed 100 billion this year, eclipsing the record 69.4 billion in 1955. Many forecasters fear the gap will widen even further in 1985.

"The U.S. is now experiencing a massive, historically unprecedented erosion in its international trade and financial position," concludes C. Fred Bergsten, director of the Institute for International Economics in Washington.

What's behind the nation's large and growing trade deficits? Economists point to three factors:

- The U.S. has come out of recession ahead of the rest of the world. As a result, purchases of imported products are rising faster in the U.S. than in other countries.
- Heavy debt is preventing many Third World countries from buying U.S. goods. For example, U.S. exports to Mexico tumbled from 18 billion dollars in 1981 to 9.1 billion last year.
- The dollar's buying power against foreign currencies, even after ebbing this year, is 46 percent higher than in 1980. A strong dollar boosts imports by making foreign goods cheaper here and discourages exports by raising prices foreigners must pay for U.S. products.

Taken together, those forces are flooding the U.S. with foreign goods. Paced by a big surge in manufactured goods, imports rose to 269.9 billion dollars in 1983, and they probably will reach 326 billion this year.

Exports, meanwhile, are expected to improve slightly to 213 billion dollars this year, still well below the peak of 233.7 billion in 1981. Hardest hit are manufacturers. For instance, sales of many American-made consumer goods are still sluggish in Canada.

Nevertheless, some export gains are anticipated in 1984, including sales of machinery and aircraft to Japan and high-technology gear to Western Europe and Asia.

The overall U.S. trade picture would be bleaker if not for lower oil prices, which since 1981 have shaved 20 billion dollars from the deficit with the oil-producing countries. Elsewhere, the U.S. has been falling further behind.

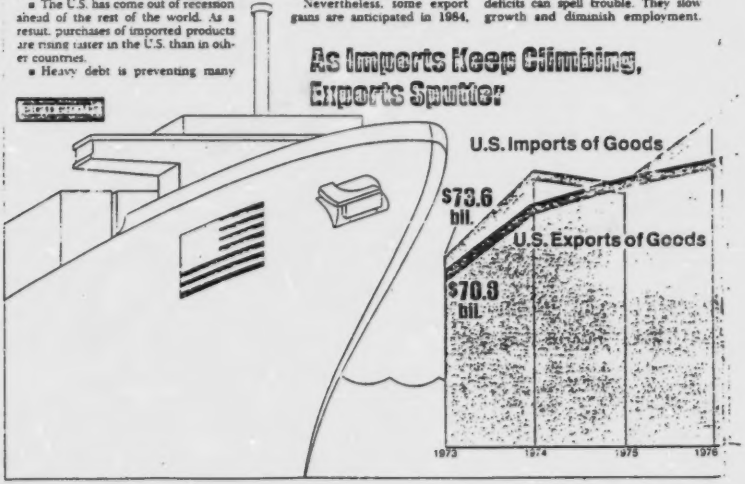
Japan's trade surplus with the U.S. rose to 19.3 billion in 1983, compared with 15.8 billion before the dollar's rise began in 1981. At the same time, Canada's favorable balance grew from 6.3 billion to 13.9 billion.

A more dramatic shift involves newly industrialized Mexico, Brazil, Argentina, Hong Kong, Taiwan and South Korea. A U.S. deficit of 2.2 billion in 1981 swelled to 21.6 billion in 1983. The U.S. surplus with Europe's Common Market sank from 10.7 billion in 1981 to 400 million in 1983.

**Some fringe benefits.** The mounting trade deficits aren't without blessings. They bring inflows of foreign assets that allow the U.S. to finance its budget deficits without crippling private investment. Low-cost imports check inflation by making it harder for U.S. firms to raise prices.

Over time, analysts argue, big trade deficits can spell trouble. They slow growth and diminish employment.

## As Imports Keep Climbing, Exports Sputter






BEST COPY AVAILABLE

They encourage overseas production, thus aiding efforts to keep basic industries in the United States. They fuel demands for trade barriers that can push up consumer prices.

Stephen Roach, senior economist for Morgan Stanley & Company in New York, contends the trade deficits leave the economy dangling precariously. His worries: One, a too strong dollar could plunge rapidly, reigniting inflation. Two, foreign investors may forsake the U.S., creating a capital shortage that would drive up interest rates.

What can be done to trim the trade deficits? There are proposals for restricting imports or weakening the dollar by blocking foreign investment in the United States. One possibility: An across-the-board surcharge on imports, as authorized by the Trade Act of 1974.

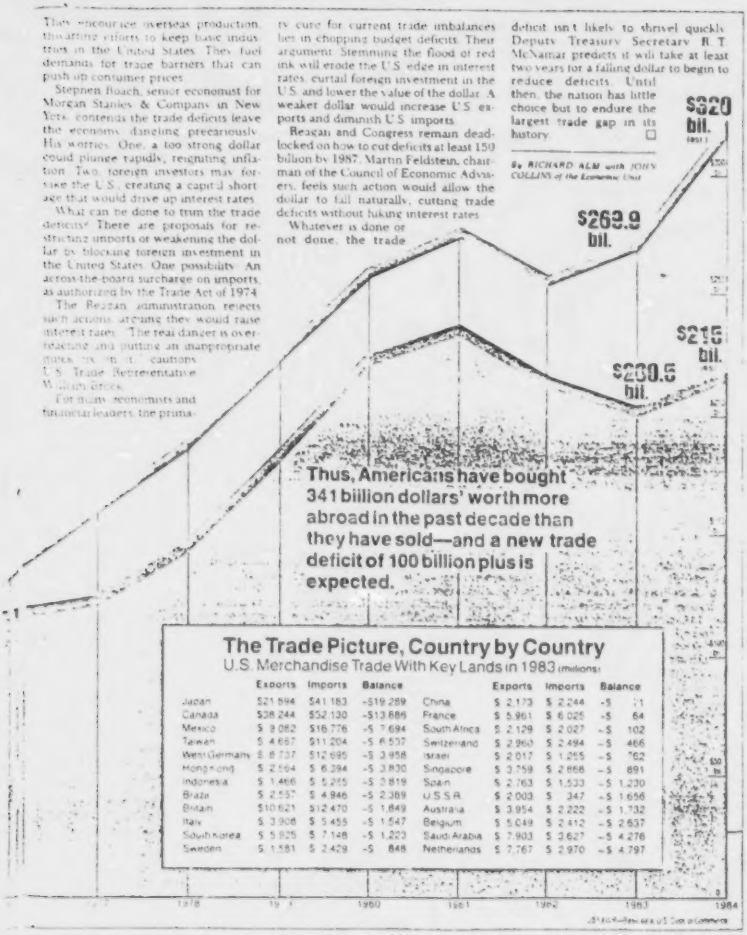
The Reagan administration rejects such actions, arguing they would raise interest rates. The real danger is overreacting and putting an inappropriate curb on the U.S. economy, cautions U.S. Trade Representative William Brock.

For many economists and financial leaders, the primary cure for current trade imbalances lies in chopping budget deficits. Their argument: Stemming the flood of red ink will erode the U.S. edge in interest rates, curtail foreign investment in the U.S. and lower the value of the dollar. A weaker dollar would increase U.S. exports and diminish U.S. imports.

Reagan and Congress remain deadlocked on how to cut deficits at least 150 billion by 1987. Martin Feldstein, chairman of the Council of Economic Advisers, feels such action would allow the dollar to fall naturally, cutting trade deficits without hiking interest rates.

Whatever is done or not done, the trade deficit isn't likely to shrivel quickly. Deputy Treasury Secretary R. T. McNamar predicts it will take at least two years for a falling dollar to begin to reduce deficits. Until then, the nation has little choice but to endure the largest trade gap in its history. □

By RICHARD ALM with JOHN COLLINS of the Economic Unit




**Thus, Americans have bought 341 billion dollars' worth more abroad in the past decade than they have sold—and a new trade deficit of 100 billion plus is expected.**

## The Trade Picture, Country by Country

U.S. Merchandise Trade With Key Lands in 1983 (millions)

| | Exports | Imports | Balance | | Exports | Imports | Balance |
|---|---|---|---|---|---|---|---|
| Japan | $21,894 | $41,183 | –$19,289 | China | $ 2,173 | $ 2,244 | –$ 71 |
| Canada | $38,244 | $52,130 | –$13,886 | France | $ 5,961 | $ 6,025 | –$ 64 |
| Mexico | $ 8,082 | $16,776 | –$ 7,694 | South Africa | $ 2,129 | $ 2,027 | –$ 102 |
| Taiwan | $ 4,667 | $11,204 | –$ 6,537 | Switzerland | $ 2,960 | $ 2,494 | –$ 466 |
| West Germany | $ 6,737 | $12,695 | –$ 3,958 | Israel | $ 2,017 | $ 1,255 | –$ 762 |
| Hong Kong | $ 2,564 | $ 6,394 | –$ 3,830 | Singapore | $ 3,759 | $ 2,868 | –$ 891 |
| Indonesia | $ 1,466 | $ 5,285 | –$ 3,819 | Spain | $ 2,763 | $ 1,533 | –$ 1,230 |
| Brazil | $ 2,557 | $ 4,946 | –$ 2,389 | U.S.S.R. | $ 2,003 | $ 347 | –$ 1,656 |
| Britain | $10,621 | $12,470 | –$ 1,849 | Australia | $ 3,954 | $ 2,222 | –$ 1,732 |
| Italy | $ 3,908 | $ 5,455 | –$ 1,547 | Belgium | $ 5,049 | $ 2,412 | –$ 2,637 |
| South Korea | $ 5,925 | $ 7,148 | –$ 1,223 | Saudi Arabia | $ 7,903 | $ 3,627 | –$ 4,276 |
| Sweden | $ 1,581 | $ 2,429 | –$ 848 | Netherlands | $ 7,767 | $ 2,970 | –$ 4,797 |



BEST COPY AVAILABLE

EXHIBIT II

The Wall Street Journal
May 24, 1984

*Falling Short*

# Export-Trading Firms In U.S. Are Failing To Fulfill Promise

## Authorized by Government In '82, Most Have Made Only a Few Small Deals

## The Japanese Offer Advice

By Steve Weiner and Robert Johnson
*Staff Reporters of The Wall Street Journal*

Michael Granat well remembers the struggle to find business for the export-trading company established last July by Union Bancorp of Los Angeles.

Although the bank thought it was offering its customers new trade opportunities, its clients mostly weren't interested, sometimes for unexpected reasons. "A man who makes pool equipment told me he wasn't 'emotionally ready' to export," says Mr. Granat, president of the trading unit. "I told him, 'Look, I'm emotionally ready.' But I didn't get the contract."

So far, Union Bancorp's trading company has generated revenue of only $250,000 and Mr. Granat's attitude towards export trading has changed. For the time being, he says, "nobody's going to make it big."

He is apparently right. Export-trading companies, which act as middlemen to match international buyers and sellers, were hailed as the first step toward a U.S. foreign-trade revival when they were authorized by Congress in October 1982. But the export-trading companies and other foreign trading concerns have mostly failed to fulfill their promise. Almost no U.S. trading company is making money, and most have managed to pull off only a handful of small deals. Even the largest players, such as Sears, Roebuck & Co., are stumbling.

"You do get the feeling that there are quite a few people thrashing around trying to figure out what they would like to do," says George J. Stathakis, president and chief executive officer of General Electric Trading Co., a unit of General Electric Co. and one of the few established concerns in the export-trading business.

### Sears Is Mum

The most obvious thrasher is Sears. Late last month, Roderick M. Hills resigned as chairman and chief executive officer of Sears's export-trading unit, Sears World Trade Inc. Mr. Hills, a former Securities and Exchange Commission chairman, says he resigned by mutual agreement. Sears merely says Mr. Hills resigned and won't say much about Sears World Trade. But the unit had losses of $16.3 million for the five quarters ended March 31 on revenues of about $120 million. Sources inside the company say the five-year plan prepared by Mr. Hills is being reevaluated by executives, who worry that it is too aggressive and risky to fit in with Sears's traditionally conservative approach. Sears confirms a reevaluation.

Among others in the business now doing some reevaluating is Security Pacific Corp. of Los Angeles, which, according to one official, thought "people would be lined up at the door" when its trading company opened for business last year; instead, only a few transactions have been completed. First Chicago Corp. has won only two consulting contracts since its trading venture was launched in December. The trading company operated by the Port Authority of New York and New Jersey "may never be self-sustaining," says project director Herbert Ouida. And Control Data Corp.'s high-tech-oriented trading entity went out of business.

"I don't know what people expected," says Commerce Secretary Malcolm Baldrige. "People lined up for five blocks? That's not going to happen." The hardest part of exporting is starting, he says, adding: "It's the fear of the unknown."

### New Development

Americans have long been known as "Yankee traders"; but until recently, trading companies were rare in this country. Individual companies marketed their goods overseas, the smaller ones assisted by export-management concerns that set up distributor networks for client companies. But no one filled the world-wide buying and selling functions of the Japanese trading companies, which buy, sell, market and develop goods and services, from food to industrial gear, throughout the world.

The Export Trading Company Act of 1982 was designed to make it easier for U.S. companies to trade abroad. It removed antitrust obstacles to joint trading ventures among companies in the same business and made it legal for banks to trade. So far, about 45 companies have signed up to form export-trading companies.

One reason behind the companies' moves, says Mr. Stathakis of GE, is that the U.S. economy isn't expected to grow as fast as commerce in the rest of the world. With the foreign-trade deficit soaring, to perhaps $100 billion this year from $69.4 billion in 1983, government policy makers are encouraging exports. And more companies are encountering the need for "countertrade" and barter skills. One recent study found that 58 countries now require some form of countertrade, in which the U.S. exporter, to complete the deal, promises to buy or market products from the partner nation. In 1972, only 15 countries had such requirements.

But the trading-company act also came as the world-wide recession plunged demand for U.S. goods. Many foreign economies lacked currency, and many prune U.S. trading partners, such as debt-burdened Latin American countries, couldn't afford trade. Countertrade requirements befuddled some companies, and the rising value of the dollar put prices for U.S. goods 20% to 30% out of

BEST COPY AVAILABLE

# Falling Short: Authorized by the Government in 1982, Export-Trading Firms Are Failing to Fulfill Promise

*Continued From First Page*

line. The timing of the 1982 act was like "giving a guy a sailboat, and the first time out, he runs into a hurricane," says Michael J. Cosgrove, chief financial officer of GE's trading operation.

Even the big Japanese trading companies, estimated to control at least 10% of U.S. exports, have felt the pinch. Mitsubishi Corp., the largest Japanese trading house, with revenues approaching $70 billion, said its U.S. trading volume fell 4.5%, to about $12 billion, in fiscal 1983. At Marubeni America Corp., Senior Vice President Koji Hiroshima, speaking of the company's U.S. export business, says: "We are hurting."

A principal problem of the U.S. export trading companies is that they tend to lack experience and expertise. Many of the trading companies that have received government certificates to operate are such neophytes that the Commerce Department's "how to" handbook for creating a company contains such elementary definitions as "ship, n." a phrase referring to the side of a ship. And inexperience leads to unreasonable demands, says Michael R. Czinkota, a Georgetown University researcher. Americans "want the 'three ins': in advance, in gold and in Zurich."

Despite their problems, the largest companies have been recruiting extensively. GE, for instance, has 60 bilingual, M.B.A.-holding engineers, 70% of them foreign-born, in its countertrade department alone. But most export concerns are tiny. Union Bancorp, for instance, employs just eight people.

However, there is more to the business than numbers. "International trading takes teamwork," says Yoshi Tsurumi, a professor of international business at Baruch College in New York. "It's all maintained by personal relationships, by professional managers and traders." Most big U.S. companies lack such people—generally entrepreneurial and opportunistic spirits—and don't see the need for them. "Not much international trading can be reduced to job descriptions," he says.

So many U.S. traders are learning through on the job training. Year-old Citicorp International Trading, among the few banks making trading a big part of their business, is still "sorting out the multiple opportunities," says James W. Stevens, executive vice president of the parent, Citicorp.

More typical is U.S. Farm-Raised Fish Trading Co., formed in Jackson, Miss., to find the elusive international market for catfish. Fish traders couldn't understand why their bread-battered catfish samples were being ignored during a recent Tokyo food exposition. Then, someone put out a platter of raw fish. "They cleaned us out," says a bemused Larry Joiner, the group's president. So far, however, few orders have been received.

Duane L. Repp, president of D.M.T. World Trade Inc., Waukesha, Wis., sells electric motors and pumps but has found it isn't always easy to get what the customer wants. For example, a Saudi Arabian businessman has asked him to find a machine to make lollipops; but so far, Mr. Repp has failed in that task.

Most corporate-trading arms tend to concentrate on countertrade for the company's own products. C.E. Trading Inc., for instance, trades in such diverse items as machine tools, minerals, palm oil, fertilizer and shoes to further the business of its parent, Combustion Engineering Corp. But Honeywell Inc.'s trading unit, Honeywell High-Tech Trading Inc., also sells goods and services from other concerns in related electronic lines, carving out a comfortable niche by using an existing distribution system. So far, Honeywell has signed 21 sales agreements with other companies.

Such deals with non-exporting companies are the bulk of business being sought by bank exporting companies. An estimated 20,000 companies could export products but don't. Even so, some bankers aren't certain how to apply their international financial experience to actual trading. "We're going up against formidable opponents everywhere," says Peter M. Nelson, president of Bank America Corp.'s trading company. "I don't think we're going to be very big in a couple of years."

GE Trading, the largest U.S. trading company, won't be profitable until 1985, President Stathakis says. Begun in 1982, its volume last year was $500 million, plus countertrade in support of other GE exports valued at about $400 million. Such countertrade and the company's existing export base of about $4 billion a year are the trading company's foundation.

About 90% of GE Trading's exports are the company's own products. But the company plans to grow into new areas. Already, its countertrade needs have pushed it into metals markets, and Mr. Cosgrove, the financial officer, says GE Trading may make acquisitions this year, possibly in the financial-services and general-commodity areas.

It is a company built on an entrepreneurial and opportunistic base with a goal of becoming a general trading enterprise. "The only limitations on trading are your own imagination and the ability to put together a deal," Mr. Cosgrove says.

GE Trading's biggest coup was a complex barter deal with Romania that saved a $186 million sale of two turbine generators. When the deal appeared to fall because of a Romanian monetary crisis in 1982, GE Trading agreed to take half of its payment in such goods as nails and television sets. "It's the first nuclear-power plant in the world to be paid for in nails," quips P.A. "Tak" Argenbright, GE's countertrade chief.

As a general trader with an immense consumer base, Sears World Trade is the better known of trading companies, and its goals have been vast. "The scope of our ambition is as large as any of the Japanese trading companies," Mr. Hills said in an interview earlier this year.

Sears World Trade wants to be able to provide any product which any customer might want anywhere. It buys and sells lumber products world wide, offers management consulting services, supplies goods for other retail chains. It finds ways for developing countries and businesses to improve their products, making them more suitable for world trade. It finds buyers and provides financial, insurance and shipping services. "We add value to articles of trade," Mr. Hills said in the interview.

Sears originally saw its trading company as an importer and exporter of consumer goods that would build on the company's world wide base of suppliers. Mr. Hills, named chairman in October 1982, instead molded a general trading company with a broader focus on consumer, high-tech, health and agricultural goods and services.

Despite the losses, Sears World Trade was progressing according to plan, insiders say. Joint ventures had been formed in Germany, Italy, Hong Kong, the Philippines and England. "We established a distinguished global presence," Mr. Hills says. But the trading company was moving too quickly and with too little assurance of success for some senior Sears officers.

"The issue is what the scope of the activity should be," one insider says. "I'm not sure (senior officers) appreciate that one has to get out in the water, negotiate and make deals. You've got to have a lot of faith."

Japanese traders say it will be hard work and slow growth that make the most successful U.S. trading houses. "Even for us, it took more than 100 years," says Shinichiro Wada a division manager for Mitsubishi International Corp., New York. The U.S. export companies "are still groping, but it's premature to say whether they're going to be successful," says Mr. Hiroshima of Marubeni. "I haven't heard any success stories yet, but give it time."

BEST COPY AVAILABLE

88 THE WALL STREET JOURNAL Tuesday, May 8, 1984

EXHIBIT III

# Latin Debt Crunch Hurting U.S. Firms

By Everett G. Martin
Staff Reporter of The Wall Street Journal

Minnesota Mining & Manufacturing Co. has given up selling its video cassettes and copying machines in Latin America. A brand new Ford Motor Co. truck plant stands empty in Argentina. Du Pont Co.'s chemical exports to the Southern Hemisphere dropped 20% last year.

These are examples of how U.S. companies have become victims of the Latin American debt crisis.

In fact, Glenn C. Bassett, managing director of the Council of the Americas, an organization of about 200 major U.S. companies doing business in Latin America, argues that with less exports sales, delayed payments and costly red tape, U.S. businesses are being hit harder by the debt crisis than the banks that made the problem loans in the first place.

While banks have profited from higher interest rates and fees they charge for stretching out debtors' loans, and haven't yet had to write off any significant loans as losses, business firms have lost considerable income and must reflect that fact in their income statements. The U.S. companies also have to fall in line behind the banks to get hard-currency payments from Latin central banks.

## Hard to Quantify

"It is all hard to quantify because we don't get that much information from the corporations themselves," Mr. Bassett says, "but the impact is substantial."

Commerce Department trade statistics give some indication of just how substantial. U.S. exports to the region dropped 42% to $6 billion last year from $28.6 billion in 1981, the year before the crisis set in. By comparison, U.S. exports worldwide slid only 14%, to $336.5 billion in the same period, according to the Department of Commerce. The drop in U.S. exports to Latin America accounted for almost half of the $53.3 billion decline in total U.S. exports between 1981 and 1983.

Much of the export decline is blamed on the strong dollar, which has priced U.S. goods out of world markets and helped push the overall merchandise trade deficit to record levels in the past two years. But Michael Liikala, a special assistant to the Commerce Department's head of international trade, says, "The largest factor in the increase of our trade deficit has been the Latin American debt crisis."

For the past two years, such formerly big U.S. customers as Mexico, Venezuela, Brazil, Argentina, Peru and Chile have been struggling just to pay the interest on their debt. Their trade credits have dried up, and most of them have clamped tight limits on imports to create the favorable trade balances required to get money from the International Monetary Fund. "We hoped that they would get out of it through increased exports," says Mr. Liikala, "but it has been primarily an import-contraction kind of adjustment."

## Workers Pay a Price

The U.S. worker has also paid a heavy price as a result of lost Latin business. The Commerce Department figures that each billion dollars in trade means 25,000 U.S. jobs, which could mean that 400,000 American workers either lost their jobs or weren't hired as U.S. exports shrank by $16.3 billion between 1981 and 1983.

Olin Corp. has lost "substantial" chemical exports and as a result has had layoffs in some facilities "that wouldn't have been as great if our Latin American business hadn't fallen off so much," says International Vice President Edward B. Pollak.

Overall, chemical sales to the Latins are off nearly 20% since 1981, while exports of vehicles and parts to the region dropped by almost a third below usual levels. But L. Lindsey Halstead, Ford's vice president for Latin America, says, "Our U.S. workers have maybe lost some overtime. I doubt that there have been any layoffs."

The auto industry's experience is much like that of 3M, where Joseph M. Ramos, executive director for Latin America, says lost exports were offset by resurgent sales at home. "Imported finished goods in Latin countries have been virtually cut off," he says. "Before, our product was in Brazil, for example, included 10% imported products and now it's down to 10%." He recalls nostalgically that "video tape cassettes was one of our fastest-growing markets. Today it is virtually prohibited to import them because they are considered luxury items. The same thing has happened with our copier machines."

Xerox Corp. faces a different problem. It produces copiers in Brazil and Mexico, but they need imported components. Xerox has had to scramble for ways to keep its affiliates supplied. "I could write a book on this," says Philip D. Fishback, vice president of finance and administration for the Xerox Latin American Group. "It consumes my whole day."

Xerox gets around import restrictions by such schemes as qualifying local firms to produce many of its components in Brazil, Mexico and Argentina. It not only uses the parts locally but ships them to its plants in other parts of the world. By creating export income in this way for the Latin countries, officials are more willing to allow Xerox to import U.S.-made parts, the company says.

Last year Xerox even set up a general trading company in Brazil to sell all types of Brazilian commodities and manufactured goods abroad, all to build up good will that would enable Xerox to import parts from the U.S. Xerox's U.S. exports to Latin America still have dropped, but Mr. Fishback says it is more because of the recession there than import restrictions.

Strapped for foreign exchange and cut off from trade credit, many Latin countries talk increasingly about bartering their products for imports they need. But U.S. firms find barter deals hard to close with the Latins. "It's lack of vision and understanding of what it's about on the part of their bureaucrats," says an export sales executive at a large U.S. electrical equipment maker.

Ford has suggested that Brazil strike a barter deal with Venezuela so Ford can ship Brazilian-made auto parts to its Venezuelan assembly operation that the Venezuelans would pay for with oil. But, says Mr. Halstead of Ford, "No one has risen to the bait. It's very hard to put a deal together."

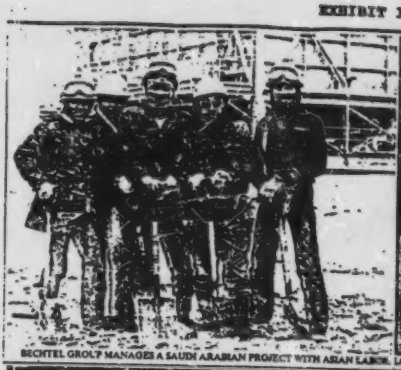
## U.S. Exports to Latin America Fell Faster Than All U.S. Exports

| | Exports to World | | | Exports to Latin America | | | Latin American Share of Decline in U.S. World Exports |
|---|---|---|---|---|---|---|---|
| | 1981 | 1983 | Decline 1981-83 | 1981 | 1983 | Decline 1981-83 | 1981-83 |
| **Total (Billions)** | $233.7 | $196.5 | -14% | $30.0 | $22.6 | -42% | 19% |
| SELECTED AREAS: | | | | | | | |
| Manufactured Goods | $154.3 | $122.5 | -14% | $29.7 | $15.2 | -49% | 67% |
| Machinery & Transportation Equip. | 95.7 | 82.4 | -14 | 17.8 | 8.2 | -54 | 73 |
| Automobiles | 7.9 | 4.5 | -42 | 3.6 | 1.3 | -64 | 85 |
| Civilian Aircraft | 12.5 | 10.7 | -21 | 3.4 | 1.1 | -67 | 27 |
| Construction Equipment | 6.3 | 2.6 | -62 | 1.5 | 0.3 | -79 | 31 |
| Agricultural Machinery | 3.5 | 1.6 | -54 | 0.7 | 0.1 | -86 | 29 |

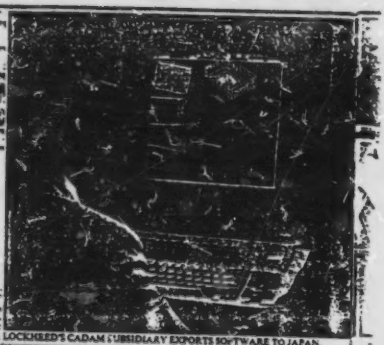
Source: Department of Commerce, Bureau of Census

BEST COPY AVAILABLE

EXHIBIT IV



BECHTEL GROUP MANAGES A SAUDI ARABIAN PROJECT WITH ASIAN LABOR.



LOCKHEED'S CADAM SUBSIDIARY EXPORTS SOFTWARE TO JAPAN.

Foreign

# THE NEXT TRADE CRISIS MAY BE JUST AROUND THE CORNER

## AMERICA IS LOSING ITS EDGE IN SELLING SERVICES OVERSEAS

The world of services is a world of ideas, where an impressive lead can be lost overnight and copyrights and patents offer little protection. For years the U.S. has been on a roll at this high-stakes table—the big winner in an international market in "invisible" trade estimated at $700 billion or more. Despite the recessions of the 1970s, the U.S. created millions of new jobs through its service industries.

But now that business could be headed the way of trade in tangible goods. From boardrooms in Frankfurt, London, and Tokyo to grimy warehouses in São Paulo, tough new foes are elbowing into the market for business and personal services. Already, trade specialists are identifying American services—including travel, tourism, aviation, and leisure pursuits—that they say resemble the U.S.'s declining smokestack industries.

Many of the foreign service companies racing to catch the U.S. have a long way to go. In finance, software, advertising, television, and other fields, the U.S. holds a commanding lead. Eight of the top 10 ad agencies in the world are American. And despite strong British and Japanese competition, U.S. insurers are expanding into world markets.

But the edge is fragile. If profits earned from foreign investments and repatriated to the U.S. are excluded, the American service champion becomes an also-ran. By that measure, Europe exports three times more services than the U.S. And if "smokestack" services such as tourism and shipping are excluded, the U.S. ranks fourth in exports behind Britain, Germany, and France.

**NEW STRENGTHS.** Because of the strong dollar and world recession, but also because of the new competition, U.S. service exports fell in 1982. Service exports that year were just 1.3% of gross domestic product—less than in 1980 and the lowest among industrialized countries. Estimates for 1983 show the U.S. service surplus shrank, for the second year in a row, to $6.5 billion from $7.6 billion.

The truth is no one really knows how competitive the U.S. is in selling services, because numbers are notoriously unreliable. Some experts, such as Geza Feketekuty, Assistant U.S. Trade Representative, argue that the U.S. is strongest in newer fields, such as consulting and data processing, where sales could be significantly undercounted.

But competition is growing. Service exports can no longer be relied on to help balance the U.S. merchandise trade deficit. "There is probably a trend away from a U.S. surplus," warns economist Gary R. Saxonhouse of the University of Michigan. "As in everything else, our competitors overseas are becoming more competitive in services."

A declining dollar will not solve U.S. service exporters' problems. In fact, as the yen appreciates and becomes a global reserve currency, Tokyo will become a deeper, more experienced market where bigger deals are done. Says David Blitzer, chief economist for Standard & Poor's Corp.: "With that would come increasing demands for Tokyo-based financial information services." Even in venture capital and investment banking, says Robert D. Hormats, former Assistant Secretary of State and now a vice-president of Goldman, Sachs & Co., Japanese companies such as Nomura Securities and Sumitomo will take market share.

U.S. deregulation is a double-edged



BEST COPY AVAILABLE

AMERICAN MEDICAL INTERNATIONAL RUNS TESTS IN LONDON, AND GERARD FORD'S MODELS SEEK MORE EUROPEAN BUSINESS

sword. Although deregulation of the U.S. economy leads to greater efficiency and productivity, it also opens up the U.S. market to foreign incursions. Indeed, the current liberalizing of financial services in London and Tokyo occurred only after major players in those markets learned the game in the U.S.

Pressure is exploding to deregulate foreign capital markets and revolutionize archaic business practices that are centuries old. Trading in all kinds of financial instruments now goes on in markets around the world that never close. "The revolution in the U.S. is beginning to take place in Europe and Japan," says Joan E. Spero, senior vice-president of American Express Co. "There is heightened competition everywhere."

The U.S. has new competitors in:

□ **Space telecommunications.** In France, the Ariane rocket has ended the U.S. monopoly in commercial satellite-launching, a $6 billion to $10 billion market over the next decade. By 1990, Tokyo will have its own rocket capable of launching two-ton communications satellites, thereby orbiting Japan into the space telecommunications business.

□ **Advertising.** In Britain, Saatchi & Saatchi Compton PLC, the ad agency that created the media blitz for Margaret Thatcher's first election campaign in 1979, has swallowed two U.S. agencies, and it is now a major force on New York's Madison Avenue. Just 12 years old, it is the eighth-largest in the world.

□ **Software.** In Brazil and India, software companies are exporting their sophisticated wares to European and U.S. companies, including Germany's leading manufacturer, Nixdorf Computer.

□ **Construction.** In the Mideast, the U.S. is being pushed aside by Asian competitors. In the U.S., mighty contractor Bechtel Group Inc. has taken refuge in a partnership with one of the biggest new powerhouses, Korea's Hyundai Engineering & Construction Co.

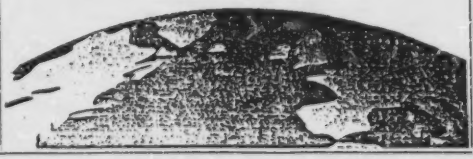
□ **Real estate.** Inside the U.S., Canada's Olympia & York Developments Ltd. has catapulted to No. 2 developer in the real estate market. And Japanese banks are now mainstay lenders to U.S. companies, providing $1 of every $14 in commercial and industrial loans last year.

More and more American homes are financed by Japanese savings. Millions of dollars in Government National Mortgage Assn. certificates, pools of government-backed mortgages, have been sold in the Tokyo capital market. Because reinsurance markets are so fluid, the risks

## HOW SERVICE EXPORTS HAVE ZOOMED

| Country | Percent increase 1977-81 | Percent of economy dependent on service exports |
|---|---|---|
| U.S. | 76.4% | 1.3% |
| BELGIUM | 47.3 | 14.0 |
| BRAZIL | 83.3 | 0.8 |
| BRITAIN | 56.0 | 6.2 |
| CANADA | 60.9 | 2.7 |
| FRANCE | 75.1 | 6.6 |
| ITALY | 62.0 | 5.5 |
| JAPAN | 90.5 | 1.9 |
| MEXICO | 161.8 | 3.7 |
| NETHERLANDS | 89.9 | 11.8 |
| NORWAY | 78.0 | 12.7 |
| SINGAPORE | 171.0 | 62.2 |
| SOUTH KOREA | 111.5 | 8.5 |
| SWEDEN | 84.6 | 6.4 |
| SWITZERLAND | 54.7 | 6.7 |
| WEST GERMANY | 66.4 | 4.5 |

DATA: OFFICE OF THE U.S. TRADE REPRESENTATIVE





BEST COPY AVAILABLE

## SPACE LAUNCHING: FRANCE WILL GIVE NASA A RUN FOR ITS MONEY

In space-launching services, France and the U.S. are playing for keeps. Ariane, the rocket designed by a French-led consortium, has had its share of delays and mishaps. So when the National Aeronautics & Space Administration's space shuttle sent two satellites into useless orbits—causing its London underwriters' losses to soar—the French found it hard not to break out the champagne.

At stake is a big business in launching communications satellites. More than 320 nongovernmental satellites are expected to be heading skyward over the next 13 years. Arianespace, the consortium enterprise, is booked through 1985 with 15 satellites. The shuttle, too, is virtually filled into 1986.

**PAYING FOR PRESTIGE?** But the two are still vying on launch timing and prices. Both NASA and Ariane have been offering promotional, low-cost fares that will rise soon. Ariane charges about $25 million per satellite carried into orbit, while NASA has been offering launching service for about $18 million. Ariane Secretary-General Roland Dumas says the space shuttle's true cost could be as high as $275 million. "As long as the competition is unfair, the shuttle will win," he says. "But I cannot see the American taxpayer supporting such a program for years and years, even for reasons of prestige."

In 1986, NASA will raise its price to about $25 million per launch. But it says costs will drop sharply once it increases launches to about 25 a year. A full cargo bay of five spacecraft will eventually pay for the flight, the agency says. NASA blames its recent mishaps on a subcontractor, but Dumas says Ariane's launches are simpler and more efficient. Since satellites launched by Ariane need less propellant, "they can carry bigger batteries for longer life," he says. "The extra energy we can pack into a satellite like GTE's G-star can mean millions of dollars of additional profits." NASA retorts that it can carry the biggest payloads.

Other U.S. contenders are commercial satellite launchers Transpace Carriers Inc. and General Dynamics Corp. Transpace could join the fray as early as October, taking on Ariane by using expendable Delta rockets. Japan is also committed to developing its own launch capability by 1990 and is resisting pressure to buy U.S. technology. A Japanese launching system could yield a new competitor in space service.

of more U.S. businesses are laid off with People's Insurance Co. of China, an aggressive reinsurer with 1,300 offices worldwide.

The new service exporters depend on information, creativity, communication, and distribution. As David W. Schremp?, president of Cigna International Corp., puts it: "This is basically a people and paper business."

**SKYROCKETING MARKETS.** Nowhere is the competition more vivid than in the Pac-Man-like chomps foreign software makers are taking out of the U.S. hegemony in computer software and services. International Business Machines Corp. and other U.S. computer makers are firmly in place, starting to supply software electronically. But despite the tough odds, foreign programmers are recapturing their national markets, and governments are targeting software exports as national priorities.

British and French programmers are moving vigorously abroad with at least $100 million apiece in software exports last year—compared with some $300 million to $400 million for independent U.S. software houses such as Microsoft Corp. The vast U.S. market is a prime British target. With its companies such as Logica and others soaring growing sales worldwide, Britain "has a strong software tradition and is coming up with some very good microsoftware now," says Peter A. Cunningham, president of Input, a California consulting firm.

Although Japan is handicapped by its non-Western language, it, too, is redoubling efforts to spring from video games into new software applications and artificial intelligence. With lower labor costs, high quality control, and major investments, Japan could be a big software force (BW—Feb. 27).

Others are joining the fray. Korea's Daewoo, Gold Star, and Hyundai conglomerates are racing to find U.S. partners. Says Han-Jong Lee, assistant to Daewoo Chairman Kim Woo Choong: "Software will be a major business opportunity for us soon."

In business information services, European companies already hold strong positions. Reuters Ltd. dominates the financial information market with instant quotes on commodities, bonds, and international currencies. Its competition includes another British-backed company, Telerate Inc., which is 51.5% owned by a London money broker, Exco Inc. French companies, one of which bought Wharton Econometrics last year, are making strong moves in the U.S., and Thyssen-Bornemisza, a Swiss-German conglomerate, has acquired a group of big U.S. data base companies.

According to Steven K. Sieck, director





BEST COPY AVAILABLE

## SHIPPING: MODERN FLEETS AND CHEAP LABOR FAVOR TAIWAN

Western countries have already lost their dominance of one of the oldest international service industries: shipping. Almost all of them are keeping their maritime industries afloat with protectionist rules and subsidies. Some have even joined with developing countries, dividing up the lion's share of the world's cargo.

But no one told the Taiwanese that the race was over. Having doubled its fleet's capacity since 1981, Taiwan's Evergreen Marine Corp. plans to double it again by 1986, to nearly 100,000 20-ft. container units. That will make it the world's largest container line.

Evergreen is already one of the top five companies in world shipping. It has succeeded by operating outside the cartels and by undercutting their fixed rates by 5% to 10%. Another Taiwan line, Yangming Marine Transport Corp., is said to be No. 10 in world shipping; it charges about 5% less than Evergreen's rates.

**NAVIGATION AIDS.** The Taiwan lines have two advantages: low labor costs and fuel-efficient ships that require only small crews. Loaded with computerized navigational aids, these vessels were bought at bargain prices when world shipbuilding was at its nadir. Taiwan has helped Evergreen and other shipping lines expand—providing loans for the construction of vessels by state-owned China Shipbuilding Corp., for instance—because it wants these lines to handle more of the island's $45.4 billion in foreign trade. That objective is rapidly being realized: Since 1981, the Taiwan lines' share of the country's outbound cargo has jumped from 10% of the total to about 40%.

The few remaining U.S. shippers, such as Sea-Land Industries USA—which pioneered the container revolution—U.S. Lines, and American President Lines, are also ordering big new ships. They hope that a new U.S. maritime law will ease antitrust restrictions, permitting greater cooperation.

of research for New York consultants Link Resources Corp., foreign companies own one-third of the $1.7 billion online data base market. He says that a company such as Canada's I.P. Sharp Associates Ltd. "has an advantage because they are not a U.S. company. In Europe there's a fear of being colonized by U.S. companies, even though it seems the reverse is happening lately."

After restricting U.S. time-sharing companies for years, the Japanese are finally easing entry conditions—now that their own industry is catching up. Kinokuniya, a Japanese bookstore operator, and computer companies such as Hitachi Ltd. and Fujitsu Ltd. are getting into the act. Mitsubishi Corp. is looking for a cable television or videotex joint venture in the U.S., and Nomura Research Institute and Daiwa Securities Co. have already begun to sell both Japanese and foreign data overseas.

Now that everyone can tap the world's information systems, competition in selling ideas can spring up anywhere. Elaborate computer systems have changed the ground rules and erased artificial lines between industries.

**'EQUAL ACCESS.'** But while the U.S. is pursuing deregulation, other countries may be doing the opposite. Indeed, many U.S. companies fear foreign governments will increase barriers to incubate local industries and to help pay for massive investments to modernize their telecommunications. U.S. companies, notes Washington trade consultant Harald Malmgren, could be the big losers.

The U.S. proposal to tackle service issues in the General Agreement on Tariffs & Trade in November, 1982, won a cool response from Europe and outright hostility from developing nations. Although the European Community is now more receptive after analyzing its own service export strength, France and others are resisting U.S. efforts to declare a regulatory cease-fire in the information sector. "By setting up in England, the Japanese have equal access to French markets under EC rules," complains one French insurance industry analyst. "We're being invaded without being able to invade. It's not clear we'll ever be able to catch up."

But trade barriers may be too much of an excuse. Says Walter G. Jewett Jr., vice-president of Booz, Allen & Hamilton Inc. in Chicago, "If the barriers come down, it does not mean that U.S. banks could move in and take those markets. More banks than you'd

BUSINESS WEEK 8412



BEST COPY AVAILABLE

like to think would make big mistakes."

Japanese banks raised their share of foreign bank lending in the U.S. last year to 14%. And overall, foreign shares of U.S. commercial and industrial loans have been rising steadily. As bank laws relax in Europe and elsewhere, Japanese banks are making their names even better known: The most profitable, Sumitomo, last month became the first Japanese bank to enter the Swiss market, which had been closed because of Swiss government regulations on reciprocity.

In exporting technology, design, project management, financial expertise, marketing skills, risk management, and other knowhow around the world, the U.S. in effect sowed the seeds of its own competition. The Manila-based SGV Group, for instance, is the No. 1 accounting firm in Asia and says it ranks just behind the Big Eight U.S. firms. Founded in 1946 by a young accountant named Washington Sycip, SGV has partnerships in 10 Asian countries and Hong Kong, with 4,000 partners and staff members serving more than 2,000 clients.

Italian designers such as Industrie Pininfarina, which recently contracted with General Motors Corp. to design a new Cadillac, are selling not just styling but also computer software engineering packages. A leading Italian franchiser, Benetton, with 2,500 stores around the world, links its European offices with a data transmission system for all order-taking, which it plans to link with the U.S. and Japan via satellite to a new robotized warehouse.

As the U.S. share of Mideast construction contracts tumbled from first to 12th in just five years, the big winners were Japan and Korea. Bechtel is combining its project management expertise with Korea's Hyundai to build offshore drilling equipment in California. Lockheed Corp.'s Cadam Inc. subsidiary turned to Kawasaki Heavy Industries Ltd. for Japanese distribution of its software for computer-aided design and computer-aided manufacturing.

Other engineering firms are moving into services. The KWU subsidiary of Germany's Siemens has become the first non-U.S. company to win a contract to manage a U.S. nuclear plant. Britain's John Brown PLC is selling advanced computer-assisted design services. French engineering giant Technip is also selling CAD/CAM, while Elf Aquitaine is offering drilling services for the first time. Says Jacques Rosio, deputy director: "The service company is a way for us to profit from our knowhow."

**SERVICE SENSE.** In some areas, companies must import services to stay competitive. Ford Motor Co. asked Toyo Kogyo Co. to design the small car for its automated plant in Mexico, and Jaguar Cars hired Daiichi Kiko to supervise its $90 million factory automation plans, redesign production lines, and develop new software. In addition to its fee, Daiichi will sell up to 400 robots to Jaguar.

Even Hollywood is boosting its service imports. Cinecittà, the huge Italian production area south of Rome, is fully booked for the first time in years. And in Britain, film production tripled and commercial TV production is exploding. The U.S. is still king, but "competition is increasing," says Michael Goldman, American Film Marketing Assn. president. He finds nations "showing greater interest in films on their own culture."

The U.S. still earns millions from providing education and other training services. Iowa alone, according to one estimate, collected $52 million in foreign student tuition last year.

But some congressional and business leaders are worried about the growing dependence on foreign student income. Some want to limit the training of for-

## ADVERTISING: A BRITISH AGENCY CHALLENGES MADISON AVENUE

It's an industry that loves to talk about itself. Charles and Maurice Saatchi, founders of the world's fastest-growing advertising agency, are an anomaly. The two brothers have acquired a reputation for being reticent and shy. But that has not diminished the splash that their London agency, Saatchi & Saatchi Compton PLC, has made in ad circles worldwide. Founded just 12 years ago, Saatchi is already the largest ad agency in both Britain and Europe as a whole, and it is successfully challenging the U.S. advertising giants.

Since 1979, Saatchi has grown at a compound annual rate of 43%, to $900 million in revenues in 1983. Much of that growth has been achieved outside Britain, which contributes 20% of revenues. Saatchi has expanded overseas by acquiring strong local agencies, letting them operate under their own names, and relying on central financial controls to improve their efficiency.

Its 98 offices on six continents let Saatchi pursue the big multinational accounts that have long been the preserve of U.S. agencies. It now handles advertising for Procter & Gamble Co. in 20 countries, and it caused a stir last year when it wrested British Airways' lucrative worldwide account from Foote Cone & Belding Ltd.

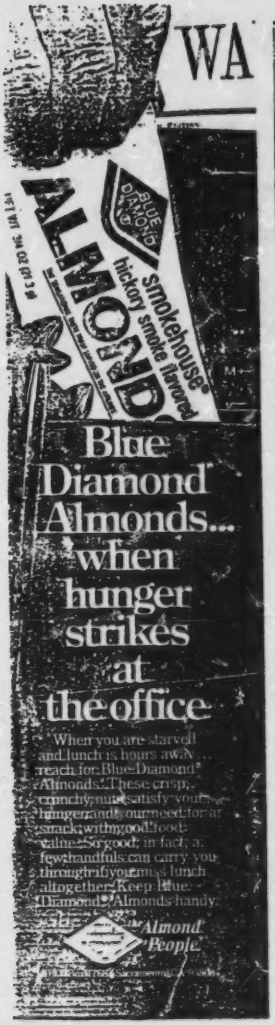
**"WORLD ADS."** Saatchi's television commercial for BA, a takeoff on the movie *Close Encounters of the Third Kind*, typifies the "world ads" usable in many markets that are helping the agency attract clients with global campaigns. Dubbed versions of this ad are being shown in 52 countries. In Britain, Saatchi is best known for masterminding the election campaign ads that helped carry the Conservative Party to victory in 1979 and 1983.

Industry observers say Saatchi's success owes as much to its drive as to its creativity. "They have always been incredibly hungry for new business and have taken any [accounts]," says Wendy Bristow, news editor of *Campaign*, a British journal.





BEST COPY AVAILABLE


WA
BLUE DIAMOND
Smokehouse
hickory smoke flavored
ALMONDS
Blue Diamond Almonds... when hunger strikes at the office
When you are starved and lunch is hours away... reach for Blue Diamond Almonds. These crisp, crunchy nuts satisfy your hunger and fill your need for a snack with good food: calorie-for-good, in fact; a few handfuls can carry you through trifying times 'til lunch all together. Keep Blue Diamond Almonds handy.
the Almond People



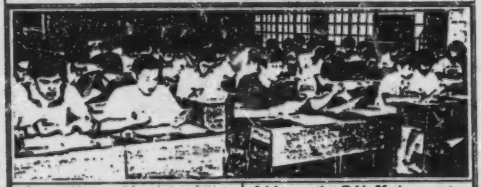
eign students to prevent "leakage" of U.S. technology.

U.S. health care companies, such as Americas Medical International, claim unmatched market leadership. But they, too, have foreign competitors. Saudi Arabia recently canceled Whittaker Corp.'s exclusive $1.4 billion hospital-management contract, opening the way for British, German, and Swedish companies to bid.

U.S. insurers have redoubled their efforts overseas to make up for their shrinking share of worldwide premiums and to enter new financial service markets. But this can work in both directions. Aetna Life & Casualty Co.'s 40%-owned affiliate, Samuel Montagu & Co., a top merchant bank, is investing heavily in U.S. property markets for British investment funds and has brought back to the U.S. new kinds of insurance products from Britain.

Mercantile House Holdings PLC, another London financial services giant, has acquired major U.S. currency and commodity brokers. "This is working both ways: U.S. institutions are going abroad, and Japanese firms are members of the Chicago Board of Trade," says Arthur Hoke, a Mercantile director. "This is creating competitive problems for many firms, but we were one of the first through the door, so it's to our benefit."

Professional services find many barriers. Ford Models Inc. has been barred from representing U.S. models in Germany, and other nations restrict professional travel services. The British want major nations to consider opening up their markets to one another, but in the U.S. the states are reluctant to give up their authority to license professionals. Immigration rules are another hurdle. Adds one Senate aide: "Can you imagine the U.S. agreeing to allow Korean construction crews into the U.S.?" ■



**INSURANCE: TOKIO MARINE'S OVERTURES TO THE U.S. MARKET**

When Albert J. Hettinger, Lazard Frères & Co. trader *par excellence* and longtime associate of the legendary André Meyer, made a fortune in the stock market in the 1960s, his biggest killings were in Tokio Marine & Fire Insurance Co. Now the world's largest marine insurer and Japan's top nonlife insurance company, it earns 27% of its premium income outside Japan, the No. 2 insurance market in the world. Because its sales staff is in-house, Tokio Marine does not have to rely on independent agents and can achieve significant economies of scale in its worldwide business.

However, its reputation may be an even bigger asset: Rather than any of the high-technology companies, it is Tokio Marine that is regularly the first choice of job-seekers fresh from Japan's universities. A company executive attributes this to "stability in the insurance industry." Adding that "university students want to work with an international-minded industry," the official notes that Tokio Marine operates in 22 countries.

This executive concedes that Japanese insurers have pushed overseas by using profits at home to subsidize their losses abroad. As for criticism of Japan's rigid market, he says these are 12 U.S. insurance companies in Japan, compared with 6 Japanese insurers operating in the U.S. "In market share," he says, "U.S. companies have about 8% of the Japanese market, but Japanese companies in the U.S. occupy a share of only 0.069%."

Founded in 1879, Tokio Marine is Japan's oldest nonlife insurer. Its U.S. operations account for about half its premium income from abroad. (Total net income for the year ended Mar. 31, 1983, was $2.5 billion.) Tokio acquired three units of Equitable Life Assurance Society in 1960, although a company official says it still lacks confidence about operating in the U.S. on its own. But American industry observers regard the units as competitors. "They are just biding their time, waiting for the market to improve," declares one observer.



BEST COPY AVAILABLE

RECOMMENDATIONS FOR CHANGES IN LAW

Mr. BONKER. If you were to recommend changes in the law, Mr. Sultan, what would you present to the committee?

Mr. SULTAN. Again on the analogy of our friends in the Midwest with their machine tools, it is difficult for us to simply build a business facilitating exports outside of the United States. We need a latitude either under the law or under the regulations that allows us to build some type of franchise that we can cover our costs.

We are a very adventurous organization, and we believe that we have made a significant contribution of our people and of our time to this effort. And my management very frankly will come to me at some point in the future, whatever that point is, and say, hey, have you covered at least the cost of these 60 people and their care and feeding, and the space that they sit in in $x$ number of countries of the world, And I am either going to be able to answer yes or no.

And if I answer no, they are going to say there is probably a lot better use for those 60 people and yourself. Or I am going to say I have been able to build up a franchise of some sort or another with a steady source of income that allows me to cover those costs, and I want some more time to try to make a fair amount of money, and simultaneously be in conformance with the spirit of the act, which would be strengthening U.S. exports.

We will, if you like, come back to you with specific written recommendations of changes that we would like to see in the law.

DISC OR FSC TAX PROVISIONS AND ETC'S

Mr. BONKER. Would you stand to benefit if we included a DISC tax provision in the legislation? We originally had a DISC tax provision which would have allowed exporters to defer taxation on income derived from exports. Would you qualify for such a tax break?

Mr. SULTAN. Well the DISC law, of course, expires on December 31.

Mr. BONKER. And it does not apply to export trading companies. Whatever the new tax provision is—FSC, would this help you?

Mr. SULTAN. We will be setting up a FSC. We feel that there is a benefit to that.

Mr. BONKER. Well, the earlier bill included a DISC tax provision which was knocked out. The Ways and Means Committee did not want to deal with it at the time, because they were in the process of rewriting DISC to make it compatible with GATT guidelines.

In writing the new provisions, they were supposed to extend it to export trading companies, but they did not.

Mr. SULTAN. I am saying that we cannot do that. But what we will do under the FSC legislation which we believe we are allowed to do is we will set up a foreign sales corporation. Simultaneously, if we have to figure out a way to make it happen, we would like to act as a representative for the smaller manufacturer or some band of small manufacturers that were granted an exemption under Justice to essentially run their foreign office for them.

Mr. BONKER. Well, I could see that. I mean the requirement would help some of the small people. Unfortunately we have a vote on the floor. Mr. Sultan, I appreciate your interest in the hearings

BEST COPY AVAILABLE

and your testimony. Perhaps we can keep in touch with you, especially as we look at some possible legislation to expand ETC's in the future.

Mr. SULTAN. It would be our pleasure to help in any way that we can sir.

Mr. BONKER. Thank you.

[Whereupon, at 4:16 p.m., the subcommittee was adjourned, to reconvene subject to the call of the Chair.]

BEST COPY AVAILABLE

# OVERSIGHT OF THE EXPORT TRADING COMPANY ACT OF 1982

THURSDAY, SEPTEMBER 13, 1984

HOUSE OF REPRESENTATIVES,
COMMITTEE ON FOREIGN AFFAIRS,
SUBCOMMITTEE ON INTERNATIONAL
ECONOMIC POLICY AND TRADE,
*Washington, DC.*

The subcommittee met at 2:45 p.m., in room 2200, Rayburn House Office Building, Hon. Don Bonker (chairman of the subcommittee) presiding.

Mr. BONKER. The subcommittee will come to order.

This is the Subcommittee on International Economic Policy and Trade. Today, we are meeting to review the progress or lack of progress that has been made in the creation of export trading companies.

Congress, in the last session, enacted legislation to allow the formation of export trading companies. The bill was signed into law by the President, and banks are now allowed, through their holding companies, to establish ETC's or to provide export services in various other ways.

One of the purposes behind this legislation was to enable small- and medium-size companies to come together to establish an ETC without worrying about possible violations of antitrust laws.

The subcommittee is conducting a series of hearings on export trading companies. We have heard from the Departments of Commerce and Justice, Eximbank, the Federal Reserve Board, and from a private sector witness.

To date, we have learned that many banks have filed for certification with the Federal Reserve Board, but there has been a somewhat disappointing number of applications before the Department of Commerce involving small- and medium-size businesses.

It was hoped, at the time this legislation was passed, that it would represent a tremendous step toward the involvement of hundreds of manufacturers in this country who otherwise are denied access to world markets.

We have also found that many large corporations have set up ETC's, though more as a matter of internal reorganization than pursuant to any provisions of this act. This says something about the new consciousness concerning the importance of trade, the globalization of our economy, and some of the emerging realities of international business, such as countertrade.



BEST COPY AVAILABLE

So, a lot is happening. We are conducting these hearing, to get a better idea of how industry and banks view ETC's, what progress is being made, and possibly to find ways in which we can enhance the earlier legislation to make sure we indeed realize our true potential when it comes to international trade and exports.

Mr. Roth, any comments?

Mr. ROTH. Mr. Chairman, I commend you for holding this series of hearings to review the efficacy of the Export Trading Company Act. These are ominous times for our exporters and many are facing serious difficulties in maintaining their footholds abroad.

I am therefore particularly interested in hearing of the impact that the Export Trading Company Act has had on the exporting landscape and whether this form of corporate organization is helping to diversify and expand U.S. export activities.

I don't want to take up the time of this subcommittee since we have a full panel of witnesses today. I look forward to learning of your actual experiences in working within the framework of the Export Trading Company Act.

Mr. BONKER. Thank you, Mr. Roth.

We have some distinguished witnesses, which I will introduce now.

The first is Edward Roach, vice president of International Controls for Honeywell, Inc., and also chairman of the board of Honeywell High-Tech Trading, Inc.; next will be Robert Gomperts, senior vice president, BankAmerica World Trade Corp.; then we will hear from George Becker, who represents Bankcorps International Trading Corp., and is the corporate director; and last, Richard Barovick, who is the editor and publisher of International Trade and Investment Letter, and, as I understand it, recently conducted a survey on ETC's.

Gentlemen, we are pleased that you are here, and we are sorry for the inconvenience of getting one group out and anotner group into the hearing room.

Mr. Roach, you are here representing Honeywell. I made mention of your status as the chairman of the board of its High-Tech Trading, Inc.; all questions concerning the Export Administration Act are off-limits.

## STATEMENT OF EDWARD J. ROACH, VICE PRESIDENT, INTERNATIONAL CONTROLS, HONEYWELL, INC., AND CHAIRMAN OF THE BOARD, HONEYWELL HIGH-TECH TRADING, INC.

Mr. ROACH. Mr. Chairman, Mr. Roth, I am Ed Roach, vice president of International Controls for Honeywell, Inc. I am also chairman of Honeywell High-Tech Trading, Inc.

### THE ESTABLISHMENT OF HONEYWELL HIGH-TECH TRADING, INC.

What I hope to do today is give you some insights as to why Honeywell High-Tech Trading was formed, and why we at Honeywell believe it is off to a successful start.

Late in 1981, Honeywell attended a meeting of the House Export Caucus. At the meeting, we heard a great deal about trading companies, and what Congress and other companies were planning in the area.

BEST COPY AVAILABLE

Our initial reaction was, frankly, less than enthusiastic. We did not see ourselves as a "soga sosha," a general trading company on the order of Mitsubishi or Mitsui. As the legislation made its way through Congress in 1982, however, we felt compelled to make a serious study of trading companies and how one might work for Honeywell.

Our study, which included participants from across a wide range of functional, product and geographic lines at Honeywell, reminded us that the company already had most of the essential elements necessary for success as an export trading company.

We had an effective global distribution network in place, with 25 percent of our revenues derived from international operations in 85 countries; we had over a half century of experience in international trade; and, in addition to marketing, we had established expertise in international legal requirements, communications and taxation.

For example, one of our areas of expertise is in the export of high technology products under U.S. export control regulations.

In this regard, I would like to commend the work that this subcommittee, and especially its chairman, has done on the Export Administration Act legislation. Passage of a new law is very important for U.S. competitiveness and for Honeywell and Honeywell High-Tech Trading.

Our study concluded that an export trading company should build on our established strengths. The trading company concept would have strategic value if it allowed us to leverage our existing resources and make them more productive.

This was true in general, as well as in several specific strategic areas. We, for example, did not believe our efforts in developing countries were as effective as they might be. The trading company could permit us to bring together our international resources to more effectively support our efforts in these countries, which represent markets with high growth potential. In addition, it would give us a large enough base to develop specialized competencies in areas like countertrade, necessary for success in the LDC's.

Just as important as what we did, are some of the things we chose not to do. As our name, Honeywell High-Tech Trading, implies, we would not handle general commodities but would focus on our products and the products of other advanced technology companies.

Our global distribution network is staffed with established professionals who understand customer needs and have a competence in high technology products.

Mr. BONKER. You made a statement earlier, Mr. Roach, about countertrade, and then said that your purpose was to limit your export activity, and I suspect trade activity generally, to high technology—an area where you have specialty. Yet, in countertrade transactions, when you export a high-technology product to a certain country, you may have to take bananas or something else in return. How can you keep your emphasis on high technology?

Mr. ROACH. The way we felt about countertrade, we view countertrade as not a business, per se, but merely a facilitator and a support to the other segments of the business.

Mr. BONKER. Do you engage in countertrade?

BEST COPY AVAILABLE

Mr. ROACH. Yes, we do.

Mr. BONKER. That means you have to get into the business of distributing or marketing products other than high technology.

Mr. ROACH. Not necessarily. You might take a product, but you may never handle it. You may be able to switch that off to someone else.

Mr. BONKER. OK, I will pursue that a little later.

Mr. ROACH. We feel our clients and our distribution network are best served by maintaining and improving this competency.

### CERTIFICATE OF REVIEW QUESTION AND THE NATURE OF HONEYWELL'S ETC

One of the final things we had to determine before we decided to go ahead with the trading company, was whether or not to seek a certificate of review under title III of the Export Trading Company Act.

Ironically, since it was the legislation that prompted our initiative in the area, we found that, for the present, certification would not be necessary. It, however, remains an option for us in the future.

The decision was made to go ahead with a trading company, and Honeywell High-Tech Trading began operations on the first of the year. Its clients are those companies that lack the know-how and infrastructure, but not the appetite, to sell their advanced technology products in international markets.

Our strategy is to facilitate the exporting and importing of client products worldwide. At the same time, we will expand the market for Honeywell products.

Client services include consulting, planning, marketing, communications, brokering, financing, technology licensing and transfer, and customer training.

We are headquartered in Minneapolis with offices in Brussels, Milan, Athens, Vienna, Singapore, and Tokyo. We have wholly owned subsidiaries, distributors, and sales agents in Europe, Latin America, the Middle East, Africa, and Asia.

Some may be disappointed that passage of the Export Trading Company Act of 1982 has not yet resulted in the formation of many large general trading companies. Nevertheless, we believe that there will be a number of beneficiaries of the operations of specialized export companies like Honeywell High-Tech Trading.

While it is essential for the continued operation of a trading company that it and its clients profit, others will benefit as well. For example, a trading company such as ours may also help developing countries to sell their products abroad, can give them the means to import what they need, and assists in lessening their need for foreign loans.

In addition, it expands the market for products and services produced in the United States and the rest of the industrialized world.

### CHANGES NOT YET NEEDED IN ETC ACT

With respect to the Export Trading Company Act legislation itself, I do not believe that any changes in it are necessary now.

BEST COPY AVAILABLE

Rather, it seems to me that this is the time to take a deep breath and let the concept develop.

Congress and the Federal Government could provide a useful service by publicizing the trading company concept.

The most important thing that Congress can do to help us and other exporting companies is to work to build an open international trading system and to resist enacting protectionist legislation.

Protectionism plainly and simply does not work. The apparent short-range advantages of protectionist measures invariably lead to a long-range loss of competitiveness and declining prosperity.

They also lead to retaliation by our trading partners, retaliation which is likely to be targeted at the areas of our greatest export strengths.

Additionally, we believe Congress must address the major factors contributing to the overvalued U.S. dollar. The present currency imbalance causes American products to be priced uncompetitively in world markets and, in turn, creates a significant trade imbalance.

Thank you. To summarize, Honeywell High-Tech Trading was formed because Congress helped us to discover its strategic value to Honeywell. It is organized to maximize that strategic value, but we will not be the only beneficiaries.

At the appropriate time, I would be happy to take questions, and attempt to answer those that I am able.

Thank you.

Mr. BONKER. Well, thank you, Mr. Roach. I thought that was an excellent statement.

We will now hear from Mr. Gomperts, senior vice president for BankAmerica World Trade Corp.

## STATEMENT OF ROBERT E. GOMPERTS, SENIOR VICE PRESIDENT, BANKAMERICA WORLD TRADE CORP.

Mr. GOMPERTS. First of all, I would like to say that I am here as somebody who has spent my life in international trade, not in banking.

I have had 37.5 years in international trade and that is what I hope that I can bring to BankAmerica.

Mr. BONKER. Were you acquired?

Mr. GOMPERTS. I was seduced. I was shown a challenge, and I was looking for a challenge in making a trading company out of a bank ETC. I considered it to be a challenge that I wanted to tackle, and I am enjoying it and working harder than I have worked in the last 25 years.

### BANKAMERICA'S FULL-SERVICE ETC

BankAmerica World Trade was chartered by the Federal Reserve Board on the 7th of February of this year. We are becoming—we are in the act of becoming a full-service trading company.

We deal in a variety of products, and for each of these products and in each of the geographical areas, we have people whose background is in international trade, we have a division that handles forest products, agricultural products.

Mr. BONKER. You are getting close to home.

BEST COPY AVAILABLE

Mr. GOMPERTS. I know. We are planning to open an office in Seattle very shortly. We have a division that handles high technology, a general trading division. We have a countertrade division, as well as geographical specialists on Latin America, and an office in Hong Kong, one in Beijing, as we will be opening one in Singapore and also in London on the Continent in the first quarter of next year.

So we are trying to combine regional expertise with product expertise as a trading company.

Mr. BONKER. It sounds like you are moving in a very big way.

Mr. GOMPERTS. We are doing it in a small way on a big scale. That is to say, we have very few people, and everybody is doing the work of four or five. The whole organization has less than 50 people in it.

Mr. BONKER. I have often said when people ask me what happened to Sears, that their one mistake was that they hired somebody from the Pentagon to head up the program.

Mr. GOMPERTS. You said it. One of the questions that you asked us to address was any problems or obstacles to bank participation in export trading companies? There is really only one obstacle to bank participation in export trading companies, and that is that the mentality of a banker is very different from the mentality of an international trade person.

I feel that those bank holding companies that go into the export trading company who will say, this is a different business from banking, we give them the charter, we get the right people in there and let them do the job, they will succeed.

Those that try and run it in the system of the banking world will not succeed. It is going to be interesting to see how that develops.

### INCREASED PREVALENCE OF COUNTERTRADE

Another question that you asked that we address is the effect of increased use of countertrade. Increased use of countertrade, no doubt that there is increased countertrade in the world today, makes a financially solid trading company with worldwide outreach more important than it has ever been before.

As you noted in your question to my colleague here from Honeywell, you cannot be a single item trader and engage in countertrade. You have to be prepared to handle a wide variety of products, marketing them wherever the best market for those products are.

When you sell something to Korea and take something from them, perhaps the best market for that product is in Singapore rather than the United States or Brazil or anywhere else, and you must have this global outreach to be able to effectively handle serious countertrade business.

You also have to have a certain financial stability. It takes some financial backing to do these businesses, because they don't go quickly. They are not back to back, and I would say, on an average, it takes 25 transactions that you work on for every one of them that you put together.

BEST COPY AVAILABLE

PROBLEMS WITH FED INTERPRETATION OF THE 5-PERCENT RULE

I would like to spend the rest of my time discussing some of the aspects of the 51-percent rule and how it has been interpreted by the Federal Reserve Board.

Bank trading companies are not, of course, in competition primarily with other bank trading companies who have to operate under these rules or other banks. They are in competition with trading companies that do not have to stick to these kinds of rules.

Therefore, we are really going into the fight with one arm tied loosely behind us.

I would like to address the question of the 51-percent rule again from the viewpoint of somebody from trade. The regulations read that 51 percent of our revenues must be derived from the export of goods and services.

That is a term that is typical in a bank or bank regulating organization. It seems to me that the real issue is turnover, not revenues, and the example that I would very quickly give of that, if we export $10 million worth of product and make a 10-percent profit, we have made $1 million.

If we import $100 million, and make nine-tenths of 1 percent profit, we have made $900,000 and complied with the rules of the Federal Reserve and imported 10 times as much as we have exported.

This is not the intent of Congress in the 51, or the primary export, rule. I feel that it would be well if the rules were somewhat relaxed, and that the 51 percent could be either on the basis of turnover of gross profit or net profit or revenue, or some variety of sources that could be used to judge whether indeed you are primarily active in export trade.

If we buy scrap steel in the Philippines and sell it to Singapore, it is counted as part of the 49 percent which is not export of the U.S. goods. In fact, the profit which we make on that transaction is an invisible export, a dollar profit brought back to the United States.

Third-country trade should be in my opinion completely eliminated from the judgment of whether you are doing the majority of your business in export of U.S. products.

This does not detract from U.S. products. It simply gives further strength to a trading company to do its business.

Mr. BONKER. Have you made this point to the Federal Reserve Board?

Mr. GOMPERTS. Yes. They did not agree. They were not impressed. I didn't personally make it. I look forward to the opportunity to do so, Mr. Chairman, sometime because I really think it is contrary to the spirit of the law that this is included as part of—as if it were an import when in fact what you earn on it is an invisible export and the basis of the trade has no effect on imports or exports at all.

Third, countertrade, I believe that all parts of a countertrade transaction should count as the 51 percent. What you have to take back from another country is only done to make possible the export from the United States, and as such it is an enhancement of American exports and we must do countertrade.

BEST COPY AVAILABLE

We do not choose to do countertrade. We, when we set up our company, did not say that we were setting up our company to do countertrade, but once you get out there in the market, you must be prepared to do countertrade, barter, compensation business, whatever the market demands, because all of your competitors are doing it who are not controlled by ETC's.

We feel we should have that latitude to do so. Finally, I would think it would be well if we were not restricted in meeting the 51-percent rule, to do so within a period of not more than 2 years.

We have been in operation for between 7 and 8 months. We started from a dead stop. It takes a while to get a company like this going.

We are in competition with companies who have been going tens, if not hundreds, of years. Relax the 2-year rule and give us 4 or 5 years to comply with the regulation that our business must be principally in export.

I think if those changes were made in the regulations, not in the law, but in the regulations, you would find more bank holding companies who were interested in setting up ETC's.

Thank you, sir.

[Mr. Gomperts' prepared statement follows:]

BEST COPY AVAILABLE

PREPARED STATEMENT OF ROBERT E. GOMPERTS, SENIOR VICE PRESIDENT, BANKAMERICA WORLD TRADE CORP.

Mr. Chairman, Members of the Subcommittee: My name is Robert Gomperts; I am the Senior Vice President in charge of trading operations at BankAmerica World Trade Corporation. I am very pleased to appear before the Subcommittee today to discuss the implementation of the Export Trading Company Act of 1982. There are several issues which I would like to address, including the response to the ETC Act and the Federal Reserve Board's (FRB) regulations, but first let me give you a short description of BankAmerica World Trade.

BankAmerica World Trade Corporation, which began operations in February of this year, is a full service trading company engaged in export, import, third country trade, and countertrade. We are focussing on four specific product areas: advanced technology, forest products, agricultural products and machinery, and general products (including chemicals, construction materials, fertilizer, coal, and machinery). In addition to buying and selling products, we also provide trade related services such as transportation, insurance and trade finance. Our headquarters office is in San Francisco and we have representative offices in Hong Kong and Beijing. We are planning additional offices in Seattle, Singapore, London and on the Continent.

57-212 O - 86 - 6

BEST COPY AVAILABLE

I have been engaged in international trade for over 35 years, primarily selling agricultural products in Scandinavia, Europe and Asia. I approach the subject of today's hearing, therefore, from a trader's point of view, rather than from that of a banker. My oral remarks will focus on how the Congressional mandate for ETCs to operate "principally" for export has been implemented; my written statement also addresses other sections of FRB's ETC Act regulations affecting bank-affiliated ETCs.

As a general comment, I would like to say that it is too early to assess the success or failure of the ETC Act or the companies set up under its provisions. Any new company takes time to get established and begin earning a profit. This is especially true for an ETC entering the international trade business at a time when the overvalued U.S. dollar makes exports extremely difficult, resulting in an historic level of trade deficits. Contrary to the FRB assertion that lack of response to the ETC Act is due to lack of publicity, I believe that certain changes in the law, and particularly the FRB regulations, would encourage other bank holding companies to open ETCs. I do know that the changes would enable us to become more competitive with foreign trading companies in the international trade arena.

The following discussion highlights three areas in which ETCs have encountered difficulties in getting established in international trade.

BEST COPY AVAILABLE

1. ETC REVENUES TEST

Background: Title II of the ETC Act, known as the Bank Export Services Act (BESA), requires that an ETC be engaged exclusively in international trade-related activities and organized and operated "principally" to (a) export U.S.-produced goods or services or (b) facilitate the export of such goods or services produced by unaffiliated persons by providing export trade services.

Because Congress intended ETCs to promote U.S. exports principally, FRB's regulations recast BESA's ETC definition by requiring that an ETC must be exclusively engaged in international trade-related activities and derive more than one-half (hereafter 51%) of its revenues in each consecutive two-year period from (a) exporting goods or services produced in the United States by persons other than the ETC or its subsidiaries, or (b) facilitating the export of goods or services produced in the United States by persons other than the ETC or its subsidiaries. FRB defines "revenues" to include "net sales revenues" from exporting, importing, or third country trade in goods by the ETC for its own account and "gross revenues" derived from all other activities of the ETC. While export revenues from trading non-ETC (or or non-ETC subsidiary)

BEST COPY AVAILABLE

U.S. goods and services are on the 51% side for the "principally" test, all other revenues from imports, third country trades, countertrades, and ETC (or ETC subsidiary) exported services are on the 49% side.

Problem #1: FRB requires that 51% of an ETC's revenues must come from the export of U.S.-produced goods or services of a person other than the ETC or its subsidiaries. However, the use of "revenues" as the only basis for an ETC's qualifying under BESA and FRB's regulations can be a very inaccurate test and does not address adequately Congress' concern that ETCs "principally" promote U.S. exports. For example, an ETC could export $10 million worth of American goods and earn a profit equal to $1 million. On the other hand, the same ETC could import $100 million worth of foreign goods and earn a profit equal to $900,000. Under FRB's regulations, the ETC has met the 51% of export revenues test but, in fact, has harmed the U.S. balance of trade by importing $100 million worth of foreign goods while exporting only $10 million of U.S. goods.

Recommendation #1: FRB should eliminate "revenues" as the sole basis for determining whether an ETC is "principally" engaged in exporting U.S. goods or services. FRB should substitute a variety of measures to more accurately determine that an ETC's principal purpose is exporting, or facilitating exports of, U.S. goods or services. These measures could

BEST COPY AVAILABLE

include total turnover (value of goods traded), gross profit, net profit, gross revenue, or U.S. payroll versus offshore payroll. An ETC should be required to meet only one of the tests.

Problem #2: The types of business qualifying as an export for purposes of the FRB revenue test are too restrictive. Countertrade transactions involving U.S. exports are one example. An ETC contracts with a U.S. exporter to export goods valued at $1 million to Country X. This country has countertrade requirements which obligate the ETC to buy $1 million worth of Country X's products. When the ETC sells these products to a third country, the value is counted in the 49% side, negating the revenues counted in the 51% side for the U.S. export. This is illogical because the U.S. export would not have been made without the sale of Country X's products.

Recommendation #2: The total value of the countertrade transaction involving a U.S. export should be included in the 51% side. Alternatively, only the value of the U.S. export could be counted, with the value of Country X's product put in a third category.

Problem #3: Trade between third countries does not involve an export of goods from the United States or an import of goods into the United States. However, FRB's ETC regulations now

BEST COPY AVAILABLE

require including third country trade revenues on the 49% side to achieve the Congressionally-stated goal that ETCs principally promote U.S. exports. As mentioned earlier, a new company must be allowed to compete freely if it is to be successful. In international trade, bank-ETCs must establish their credibility and engage in whatever trade will accomplish that purpose. FRB's regulations penalize such accomplishment.

Recommendation #3: Third country trade should not be a factor in the test for an ETC. If such trade is to be included, then ETCs should be able to count their earnings from third country trades in the 51% side because such revenues represent "invisible exports." That is, income to an ETC and, thus, to the United States, will result from international trade services provided by an ETC.

Problem #4: FRB defines "principally" as more than half or 51%. Unless changes are made in what qualifies as an export of U.S. goods and services, this percentage is unrealistic given the diversity of potential business and the impact of factors beyond the control of the ETC (such as the value of the dollar). Principally does not have to mean more than half. It should mean the leading activity by whatever measure. The purpose of the ETC Act is to encourage exports by encouraging companies to enter the business. A restrictive interpretation of the word "principally" by the FRB is counter productive.

BEST COPY AVAILABLE

Recommendation #4: Either change the way "principally" is defined, or stretch out the time for overall compliance to 4-5 years.

2. SECTION 23A COLLATERAL REQUIREMENT

Background: BESA limits, to 10% of a parent bank holding company's consolidated capital and surplus, the aggregate credit extensions by that company and all of its subsidiaries (including its subsidiary member banks) to an affiliated ETC. Furthermore, that Section states that "no provision of any other federal law in effect on October 1, 1982, relating specifically to collateral requirements shall apply with respect to any such extension of credit."

A week after BESA was enacted, the Garn-St Germain Depository Institutions Act of 1982 was enacted, substantially revising Section 23A's provisions on exempt or covered affiliates. However, the collateral provisions of Section 23A remained substantially as they had been prior to the Garn Act.

Nevertheless, FRB's final ETC regulations imposed Section 23A's collateral requirements on a bank holding company's subsidiary bank extensions of credit to an ETC affiliate. FRB adopted this

BEST COPY AVAILABLE

regulatory stance based on the questionable theory that the Garn Act so substantially revised Section 23A that it could not be considered a "federal law in effect on October 1, 1982." This nullified BESA's exemption of ETCs from Section 23A's collateral requirements, which remained in substantially the same form as they had been prior to the Garn Act amendments to Section 23A.

Problem: Congress enacted BESA to attract banking organizations' financial support for ETCs that could consolidate export trade services for economies of scale. This consolidation would enable small and medium size U.S. producers to export their goods and services at a lower per unit cost. Furthermore, Congress specifically wished to encourage regional and smaller banker's banks, bank holding companies and their subsidiary Edge or Agreement Corporations to invest in ETCs by reducing restrictions on trade financing provided by those institutions.

Subjecting a bank's transactions with its affiliated ETCs to Section 23A's collateral requirements contravenes the Congressionally-stated purposes of BESA by ignoring the unique credit needs of ETCs in their start-up phases. With only capital and accounts receivable, these ETCs will have extreme difficulty providing collateral for affiliated bank loans. This will limit new ETCs to handling export transactions only for goods and commodities, which are easily collateralized by bills

BEST COPY AVAILABLE

of lading and other title documents. However, ETC export financing for U.S. "services" will be extremely difficult because of the problems connected with perfecting security interests in service contracts under both domestic and international law. This is unfortunate given the increased emphasis currently being placed upon exporting U.S. services.

Although all bank holding companies can lend to their subsidiary ETCs free of Section 23A's collateral requirements, the extra costs and unavailability of obtaining funds from the commercial paper and other short-term liability markets, rather than from affiliated banks, will discourage smaller banking organizations in their attempts to obtain funds to assist their local exporters. This may explain, in part, why of the less than 30 bank holding companies that have formed ETCs, the majority are large money-center or regional organizations.

Section 23A authorizes FRB to exempt any bank transaction or relationship with an affiliated ETC, provided the exemption is in the public interest and is consistent with Section 23A's purposes. Unquestionably, Congress has determined that bank participation in ETCs is in the public interest. At the least, FRB should afford banking organizations the opportunity to demonstrate their ETC contribution to improve the U.S. export trade situation. However, FRB currently waives Section 23A's collateral requirements only where a bank issues a letter of

BEST COPY AVAILABLE

credit or advances funds to its ETC affiliate solely to finance the purchase of goods for which (i) the ETC has a bona fide contract for the subsequent sale of those goods and (ii) the bank has a security interest in the goods or in the proceeds from the goods'sale that at least equals in value the letter of credit or the advanced funds.

Recommendation: FRB's regulatory position takes advantage of a "quirk" in the legislative process whereby the Garn Act was signed into law a week after BESA, although both bills were intended to be considered concurrently. BESA's legislative history clearly indicates that Congress intended to exempt ETCs from Section 23A's collateral requirements because of a concern with hindering an ETC's competitiveness during its start-up phase. Although Congress stated it would revisit the collateral issue in the context of the Garn Act's Section 23A revisions, the legislative history of that Act does not refer to any Congressional discussion of, or intent to reverse, BESA's exemption of ETCs from the Section 23A collateral requirements.

FRB should not wait to review the ETC experience before freeing ETCs from Section 23A's collateral requirements. Rather, FRB should lift the requirements and reconsider imposing them only if its experiences with ETCs demonstrate that Section 23A has been abused by member banks and their ETC affiliates. We think it will not be abused. As an alternative, FRB could waive the

BEST COPY AVAILABLE

collateral requirements for the first 2 to 3 years of an ETC's operations. Finally, if FRB is reluctant to waive all collateral requirements, then it should consider expanding its existing waiver to include foreign currency loans for ETC affiliates to facilitate international trade in currencies other than the U.S. dollar.

Existing BESA provisions are sufficient to accomplish Section 23A's purposes to adequately protect a bank holding company's subsidiary bank against misapplication and abuse of financial resources in transactions with an ETC affiliate. BESA prevents banks from directly owning ETCs, limits a bank holding company's (or its subsidiary banking Edge corporation's) investments in ETCs to 5% of consolidated capital and surplus (or 25% for a nonbanking Edge corporation), limits a bank holding company's total loans to an ETC affiliate to 10% of consolidated capital and surplus, and places restrictions on an affiliated ETC's activities. Furthermore, Section 23A's single and aggregate limits on bank loans to ETC affiliates would remain intact. Finally, the Federal Reserve's regulations would impose substantial informational and notice requirements on ETC activities and investments, including quarterly reports and appropriate examinations.

3. ETC SERVICES

BEST COPY AVAILABLE

Background: BESA defines an ETC as a company "exclusively engaged in activities related to international trade, and which is organized and operated principally for purposes of exporting goods or services produced in the United States or for purposes of facilitating the exportation of goods or services produced in the United States by unaffiliated persons by providing one or more export trade services." Accordingly, BESA authorizes a banking-owned ETC to export goods or services produced by anyone in the U.S. and/or to facilitate the export of goods or services produced in the U.S. by unaffiliated persons by providing one or more export trade services.

However, FRB's regulations redefine BESA's stated ETC options by requiring that an ETC be "exclusively engaged in activities related to international trade and, by engaging in one or more export trade services, derives more than one half its revenues in each consecutive two-year period from the export of, or from facilitating the export of, goods and services produced in the United States by persons other than the ETC or its subsidiaries.

FRB bases it position on its perception that Congress did not intend ETCs to enter the "services" industry and export services such as general insurance, which are prohibited domestically to banking organizations. FRB believes Congress' main concern was that an ETC act principally as an intermediary providing trade services for U.S. exports of unaffiliated persons. This would

BEST COPY AVAILABLE

distinguish bank-affiliated ETCs from those major American corporations with captive trading companies that exported only goods or services of the corporate family.

Problem: FRB's regulations allow an ETC to provide trade-related services to a U.S. producer of goods or services for export. However, FRB's regulations permit an ETC to export its own (or its subsidiary's) services subject to a prohibition that revenues from such "services" exports not be included in the 51% of revenues qualifying an ECT as "principally" promoting U.S. exports. This creates an anomalous situation whereby, for example, an ETC could not comply with FRB's 51% export revenues test if the ETC exported its own (or its subsidiary's) factoring services but could comply with that test by facilitating the export of an affiliate's factoring services to assist international trade.

In late 1983, FRB Chairman Paul Volcker and Secretary of Commerce Malcolm Baldridge exchanged letters discussing their respective interpretations of what an ETC could or could not do. Commerce strongly believes an ETC should be permitted to export its own goods and services as well as to facilitate the export of goods and services produced by unaffiliated persons. FRB believes that an ETC should not qualify as a banking ETC only by exporting its own services (particularly non-trade) to foreign residents. Otherwise, an ETC could make an equity

57-212 O - 86 - 7

BEST COPY AVAILABLE

investment in an architectural or general insurance company and export only those services and still qualify as an ETC.

FRB's position is illogical because it penalizes an ETC for exporting its own U.S.-produced "services", which are the types of exports Congress wished to encourage.

Recommendation: FRB should clarify that an ETC can provide services to facilitate the export of U.S. goods or services as well as export its own goods and services, provided those services are trade-related. FRB's emphasis, thus, should be on what "trade-related" means, rather than on limiting ETC services exports. At a minimum, FRB should permit ETCs to export their own "services" if they are of the type already permitted bank holding companies under Bank Holding Company Act (e.g., data processing, factoring, leasing, etc.).

The problems discussed above can be addressed through regulatory change. However, given that FRB recently testified that insufficient experience exists to warrant change, voluntary FRB action is unlikely to occur. I would hope that Congress, as a result of the oversight process, would direct FRB to effect changes such as the ones I have discussed. I see legislative action as a less preferable alternative, due to the already overloaded Congressional calendar.

BEST COPY AVAILABLE

In conclusion, I would like to thank the Subcommittee for its interest in this important subject. Increasing U.S. exports now is even more critical than it was in 1982, and export trading companies have a role to play in achieving this goal. Speaking for BankAmerica World Trade Corporation, I am very optimistic that we can be a successful international trading company. Our job would be made easier, however, if FRB's regulations were amended as discussed above to more accurately reflect Congressional intent to support ETCs. I look forward to hearing the Subcommittee's recommendations.

Mr. BONKER. Thank you, Mr. Gomperts. That was an interesting statement. We'll now hear from your colleague, Mr. Becker.

**STATEMENT OF GEORGE H. BECKER, JR., CORPORATE DIRECTOR, BANCORPS INTERNATIONAL TRADING CORP.**

Mr. BECKER. I do not consider myself a banker. I share the comments made by Mr. Gomperts on that point.

Mr. BONKER. Two nonbankers representing major banks here.

Mr. GOMPERTS. Bank trading companies.

Mr. BONKER. Mr. Becker represents Bancorps International Trading Corp.

Mr. Becker, welcome.

Mr. BECKER. I have been in this field all my life. I made my first trip to Europe some years ago, 1931, and I have been traveling ever since.

When I was in the Department of Commerce, Mr. Chairman, before your time, I was interested in export trading companies and I tried to get the Justice Department to go along with the concept in 1959–60, and I was shot down at that time on the issue of antitrust, because the trade imbalance problem was not as serious in the late fifties as it has become in recent years.

I am happy to note that there is a change of attitudes elsewhere in Washington on that critical issue.

Mr. BONKER. You have been vindicated. I see we have a vote. There is no need to disrupt your testimony. We will go into a very brief recess, allowing us a chance to go over and vote, and pick up in approximately 10 minutes with your testimony.

Mr. BECKER. Fine.

[Recess.]

Mr. BONKER. Mr. Becker, I believe we were about to hear from you.

Mr. BECKER. Yes, Mr. Chairman.

BEST COPY AVAILABLE

## BANCORPS' MULTIBANK ETC

Our firm, Bancorps International, was among the first export trading companies organized under title II of the ETC Act of 1982. Authorization for our bank holding company stockholders investment in Bancorps was received from the Federal Reserve Board on September 19, 1983.

To the best of my knowledge, we are still the only multibank ETC organized under the 1982 act, and the only one that has regional bank holding companies as major stockholders. Earle T. Holsapple III, our president, and I own the balance of the stock, and we may be the only individual stockholders in a bank-affiliated ETC.

Our basic charter is to provide trade facilitation services to customers of the banks owned by our major stockholders. However, we are free to represent other companies in NJ; or elsewhere in the United States.

While our primary interest is in exporting products and services from this country, the high value of the U.S. dollar against other major currencies has forced us to import products in order to generate cash flow and minimize losses during the early years of operation.

The marketing plan submitted to our board some months ago states that we will trade in food commodities—corn and soybeans—and related equipment. This stems from the fact that our company is the international marketing arm of the Port Authority of Salem, NJ; in that capacity, we are promoting the sale of feed grains from the southern part of our State.

We have received our first order for a shipload of bulk soybeans for delivery later this year. The Port of Salem is constructing a grain elevator at the port. We have informed local farmers that Bancorps will pay cash for soybeans delivered to this new storage facility. Our task now is to convince the farmers in the area that they should sell to us for export rather than to one of their traditional customers. We offer prompt payment, a competitive price, and the opportunity to sell against Chicago Board of Trade futures.

We also handle high-tech items, medical apparatus and assorted consumer products including, if you would believe, Tofutti, the unique tofu-based frozen dessert that is of interest to the Japanese and other countries.

In this case, we will arrange for the licensing of the manufacturing process, since it is not practical to ship this unique product in large quantities. I mention this account only to stress that we offer a wide range of services to our clients.

The key to successful trading is a network of foreign contacts that represent or can lead a trader to effective channels of distribution. It is much easier to find a willing seller than a ready buyer. To that end, we concentrate on areas of the world where we have the best contacts and the most promising sales prospects; form that perspective, we tend to seek out opportunities in Asia, Europe, and the Middle East. Our approach to Latin America and Africa is cautious and selective. Quite frankly, at this time, we are seeking out short-term trading opportunities rather than participation in multiyear projects.

BEST COPY AVAILABLE

POTENTIALLY BURDENSOME COLLATERAL REQUIREMENTS

In addition to the 51-percent export revenue target for ETC's set forth in guidelines issued by the Federal Reserve Board, we may face problems with the collateral requirements of section 23(A) of the Federal Reserve Act.

This part of the act is not yet a problem for us, but it could become a real burden as our trading volume increases.

On January 11, 1984, our company submitted a letter to the Board of Governors of the Federal Reserve System that also touched upon the "affiliate" issue of 23(A) as interpreted by the Federal Reserve.

We claimed then that 23(A) should not apply to Bancorps International since not one of our bank stockholders owns 25 percent or more of the outstanding shares or "exercises a controlling influence" over our Board of Directors. The Federal Reserve has disagreed with our position on this matter and, to date, we have not pressed further this issue.

I might add here that the problem probably stems from the fact that we also issued preferred stock to the three banks with the controlling interest in our company, and I am sure the Fed looked upon the 33 percent of preferred stock owned by each of the three banks as a partial controlling interest, even though it is nonvoting stock.

PORT AUTHORITY INVOLVEMENT

The Export Trading Company Act of 1982 urges port authorities and similar organizations to organize export trading companies.

The legislative intent here is quite clear, but our ETC has taken the public position that the port authority in our area—Port Authority of New York and New Jersey—should not compete directly with privately financed export trading companies since the local port authority is partially financed by bridge and tunnel tolls paid by individuals, many of whom are affiliated in one way or another with private sector trading companies in our area.

There are many export-related activities that can be handled by port authorities, but we do not consider representation of individual companies to be one of them, particularly when they offer services at rates that are being subsidized by the public at large.

Mr. BONKER. Mr. Becker, I don't have the law before me, but I don't recall that either our intent or the language of the act urges ports to set up ETC's.

We did not want to disallow port involvement, since ports often have the means, particularly in smaller areas, to facilitate export opportunities. We were looking at whether or not we should allow public entities to qualify under the terms of the act, but we certainly didn't say we urged ports to go out and set up ETC's. I think we made reference to public entities.

Mr. BECKER. The act does refer to port authorities specifically, and I am glad to have this as a matter of record, because Peter Goldmark, the executive director of the New York Port Authority, and I have appeared on television in the New Jersey and New York area, and we have debated this issue in a modest way over

BEST COPY AVAILABLE

the past year, and we, in the private sector, feel very strongly about that.

And I would like to comment further on it a little bit later on, because I think the situation in the New York and New Jersey area may be somewhat unique in terms of the program of the New York Port Authority, and what they intend to do, and what they were denied the right to do by the legislatures in Albany and Trenton.

Last year, the Port Authority of New York and New Jersey submitted proposals requesting authorization to take title to goods and finance exports from the bistate area. The enabling legislation was not passed, and recently, new bills have been introduced in New Jersey that specifically prohibit the Port Authority from taking title to goods, nor shall it have the power to provide direct export financing with private lenders for the benefit of small- and medium-size exporters from New York and New Jersey.

Under this new concept, it is conceivable that private trading companies in New York and New Jersey may be able to cooperate with the Port Authority in the promotion of exports from the region. Only the issue of subsidized services from the Port Authority stands in the way. This is a particularly sensitive issue with Bancorps since the Port Authority has been calling on customers of the banks owned by our major stockholders.

### COUNTERTRADE

Today, countertrade is the buzz word of those engaged in foreign trade. It is a subject worthy of well-organized seminars, but it merits close scrutiny if one is concerned about generating short-term profits in an ETC.

We are currently involved in several countertrade deals, but we have not yet concluded both sides of a transaction. Our policy is to listen and to be responsive, but we are wary of the pitfalls involved. I believe our role is that of a minor player in a game controlled by others with greater resources.

Banks, by nature, are risk avoiders and traders must be risk takers. It is too soon to comment on whether the two points of view can coincide within a bank-controlled ETC. However, I am personally convinced that this is one of the main reasons why more bank holding companies have not organized an ETC.

We have talked to several regional banks in other States about investing in our company. Nothing has come of these discussions, but we are still optimistic that one day, an out-of-State bank will decide to join our group as a cost-effective way of participating in a concept that is basically sound and still full of promise.

Thank you, Mr. Chairman. I would be happy to respond to any questions.

Mr. BONKER. Thank you, Mr. Becker.

Mr. Barovick.

### STATEMENT OF RICHARD L. BAROVICK, EDITOR AND PUBLISHER, INTERNATIONAL TRADE AND INVESTMENT LETTER

Mr. BAROVICK. I have done a survey. I have talked to all of the bank ETC's as well as to most of the other near-ETC's that have

BEST COPY AVAILABLE

come onstream in the past 2 to 3 years. I would like to make a few comments on my findings, and then make a couple of comments about evaluating what has happened in the 2 years since the law was passed.

### FOUR TYPES OF ETC ACTIVITY

In the first place, in surveying what has happened in the last 2 or 3 years, I think you have to divide up the activity into four groups: one, the major corporations that have set up ETC's of one kind or another; two, the companies that have sought and received Commerce Department certification; three, the activities of public authorities; and, four, finally, and in my opinion, the most significant development coming out of the law, the emergence of bank ETC's.

Mr. BONKER. What was the third?

Mr. BAROVICK. Public authorities. I have put it all in my testimony.

Mr. BONKER. Like ports?

Mr. BAROVICK. Ports, and other public authorities.

Mr. BONKER. The ports are treated just like other applicants in terms of certification.

Mr. BAROVICK. Right, exactly.

### MAJOR CORPORATE ETCS

In terms of the major corporations that have entered the field, I would divide them again into three groups. First, you have major corporations that have pursued a "piggyback approach," as the Commerce Department used to call it 15 or 20 years ago, where, as Mr. Roach pointed out, companies such as Honeywell and AMF have set up ETC's that are carrying the lines of other manufacturers and thereby rounding out their own line. Their financial exposure is thereby limited, and they can make profits quickly on a new line.

An interesting example of this, although a little bit different, is a company in Little Rock, AR, Stephens, Inc., which is a very large investment banking house which has had a relationship with an Indonesian-based financial conglomerate called the Lippo Group. Stephens and Lippo set up a joint trading company called United Pacific Trading Co. It exports products from the United States to the Southeast Asia area and imports products from that area into the United States. But they got more mileage out of an existing network of business relationships that Stephens had in the Southeast United States and that Lippo had in Southeast Asia.

The second is the export trading company approach—the countertrade approach. General Motors and Rockwell have in-house trading companies which basically serve only one client; namely, the parent corporation and its various subsidiaries and branches. General Electric started out to be a piggyback approach, and then about 6 weeks ago announced after 2 years that it was changing its strategy, and General Electric is now strictly an in-house countertrade operation which would occasionally carry other companies' lines.

BEST COPY AVAILABLE

The third category among the major corporations is Sears Roebuck. Sears' approach has been quite different from the other two groups of major corporations. It has seen its export trading company or trading company as an investment operation in which it has both set up internal facilities but bought a number of other companies, and it has gone into consulting work as well as a variety of joint ventures with, for example, among others, first Chicago Bank, Shenkers, a large international freight forwarder in Germany, IRI, the Italian Government industrial holding company. It is a completely different approach from all these others.

### COMMERCE DEPARTMENT CERTIFIED ETC'S

In the second group, those receiving certification, the numbers change daily or weekly. About 65, roughly, have applied for certification, and about 40, roughly, have been certified. I just would point to a few interesting examples here.

Mr. BONKER. Any denials?

Mr. BAROVICK. Yes, I think there have been some denials, and also some asked to revise their application and their concept.

In terms of interesting cases, there have been a number of them. Obviously the Virginia Port Authority, VEXTRAC, got certified. An industry association group of fairly sizeable companies in the catfish business also set up a certification.

Perhaps the most interesting one of all that I have come across in this category is the United Export Trading Co. in Los Angeles. The shareholders are 10 individuals—well, 10 investors, partners. Nine of them are individuals who have an ongoing business of its export or import. The 10th is a bank, the bank of San Pedro, located in the Los Angeles Harbor. The group got certified, but the bank did not have to get Federal approval because (a) it is a California chartered bank, and (b) the investment was very small.

### PUBLIC AUTHORITY ETC'S

Moving on to the public authorities, the two main ones obviously are the Virginia Port Authority and, as Mr. Becker pointed out, the New York-New Jersey Port Authority. Their approaches are very different. Virginia's approach is to be a facilitator, do market research, advertising, do ancillary services, whereas the New York-New Jersey operation is a much more aggressive approach in which they are actually going to sell products. New York-New Jersey also—Mr. Becker pointed out—is looking to get into the export credit field, which the others clearly are not.

### BANK ETC'S

Let me go on to the banks which I think is the most interesting and significant response to the 1982 law. There are 32 banks that have now applied to the Fed for permission to set up export trading companies. Twenty-eight of them have already received permission. Since three are joining in a joint venture in BITCO, Mr. Becker's organization, actually 26 bank ETC's have been set up.

Just a few comments about the bank. I think the most important finding that I have experienced in this survey is that there are

BEST COPY AVAILABLE

really two streams of thought, two kinds of orientation of the banks in setting up ETC's. And on the basis of that they set up two entirely different kinds of organizations. The first is a small group of very large New York banks—Chase, Citicorp, for the most part, Manufacturers Hanover, for the most part—I will qualify these in a moment—and Bankers Trust.

What they have done is seen, in the 1982 law's granting of ability to take title, a major opening for a new form of trade finance, since they can take title, they can buy and sell, let's say, simultaneously. That ability to take title gives them a new arrow in their bow for doing deals that they could not previously do. Therefore, these four banks see the ETC law as an extension of trade finance.

Mr. BONKER. Could you name those four again?

Mr. BAROVICK. Citicorp, Bankers Trust, Manufacturers Hanover, and Chase.

Mr. BONKER. My friends here don't qualify in your first category?

Mr. BAROVICK. No. By coincidence, Manufacturers Hanover—let me get to the second category. The second category are banks that have entered the ETC field as a form of corporate diversification. Just as bank holding companies have gone into a variety of other businesses, this group of banks, the second group, which is certainly by far the larger one than has seen in the law an opportunity to engage in corporate diversification. And they for the most part are establishing what I would call an old-fashioned export trading company.

These banks, which include the Bank of America, Security Pacific, First Interstate, Shawmet, State Street in Boston, Fleet in Providence, what they are engaged in is setting up a trading company, a full-service trading company—what I would think of again as an established pattern. And these companies do—they set up distributor networks abroad, monitor the networks, they do market research abroad on the product, they feed back to the client and revise the product, and they offer ancillary services such as arranging for ocean transport and insurance. They do everything that a trading company historically has done.

Mr. BONKER. I thought they were going to do something innovative and new, but you say it is simply old-fashioned.

Mr. BAROVICK. They may be doing it in some innovative way. I want to give them another 2 years to show that. The fact that banks are going into it is innovative. But it is an established pattern.

I hope I have not stepped on any toes here.

Now, just a few more comments. In the case of Manufacturers Hanover, the bank set up an ETC to pursue trade finance, but by coincidence the bank holding company brought CIT. which is a large leasing consumer finance and factoring outfit, and they, in turn, already owned an export trading company. So under Manufacturers Hanover, you have the two extremes under a single roof.

Another thing is that there are some foreign banks involved. Hong Kong Shanghai Bank, Britain's Midland Bank through Crocker in San Francisco, and Charbot Bank in Britain through Union Bank in Los Angeles, have entered the field.

There are some banks that have not set them up, but are still looking at the concept. The Bank of Boston has said publicly it has

BEST COPY AVAILABLE

no intention of doing so. Perhaps it will change its mind. But it did do something interesting. It bought an export marketing company in the Boston area with a high technology focus. So it is pursuing a strategy, what it calls of service to exports, even though it doesn't take title and doesn't have a trading company.

Midlantic in New Jersey is looking at it, the Chemical Bank in New York is looking at it. I put the rest of my observations in my testimony.

### OVERALL RESPONSE TO EXPORT TRADING COMPANY ACT

Let me make one last comment, and that is what has been the response. I think you have to consider the response to the act in two ways. One, there has been a very considerable generation of export awareness brought about by the act as demonstrated by the presence of at least 50 new trading companies. Whatever they have done, there are 50 new organizations that didn't exist 2 or 3 years ago.

Second, there has been enormous attendance at seminars—obviously the Commerce Department put on, 8,000 or 10,000 people showed up.

Third, there have been specific actions taken by a large number of companies. If you take a look at the banks, the Eximbank has a master agreement with let's say 350 banks around the country. Most of those banks don't do much with Eximbank. But that would be the universe of banks that would not even remotely do anything in this field. And if 32 have now applied, we are seeing that almost 10 percent of all the banks in the country that have the interest or the capacity to enter into this field have already stepped forward and taken steps, applied to the Fed for permission.

Since banks are cautious organizations and are taking this a step at a time, I think they have to be given another 2 or 3 years to demonstrate some tangible expansion of trade. But they certainly have put the structure into place.

Thank you.

[Mr. Barovick's prepared follows:]

BEST COPY AVAILABLE

PREPARED STATEMENT OF RICHARD L. BAROVICK, EDITOR AND PUBLISHER, INTERNATIONAL TRADE AND INVESTMENT LETTER

I appreciate the opportunity to be here today and to report the findings of a survey of U.S. export trading companies that I have been conducting in recent months. As Editor and Publisher of International Trade and Investment Letter, and contributor to several other international business publications, I have followed the legislative process that resulted in the 1982 Export Trading Company Act and the response of U.S. business and banks to that law ever since.

I will report my findings briefly, and then draw a few conclusions concerning the impact of the 1982 statute. First of all, it is important to recognize that the trading firms that have arisen over the past two to three years should be divided into four groups or clusters. These include: (1) major corporations that have entered the field with new trading units, (2) the approximately 60 groups that have applied to the U.S. Commerce Department for antitrust certification, as provided by the 1982 law, (3) state and local governments that have taken steps to establish their own trading organizations, and (4) and in my judgment most significantly, the 32 banks that have applied to the Federal Reserve Board for authorization to create ETCs. A few comments on each of the groups is in order.

BEST COPY AVAILABLE

First, the major corporations. At least eight major American companies have taken steps to establish new trading organizations over the past several years. In none of these eight cases has the 1982 law been the immediate cause for the corporate decision to create the new group, though in at least one case the executive who proposed the corporate strategy was clearly inspired by the process of enacting the statute, which, as you know, generated widespread and important publicity. My impression is that several of the others in this group were similarly inspired or intrigued with the idea of pursuing exports through organizational changes widely discussed during the three years the law took to reach final passage.

The trading units of these major corporations demonstrate three patterns. First is a small group that includes Honeywell, AMF, and Stephens, Inc., the Arkansas-based investment banking firm. In each of these cases the company has pursued a "piggyback" strategy, a term the Commerce Department used to use 15 to 20 years ago. Here a company that is already active overseas simply broadens its product line by taking on the goods of other firms, thereby getting more mileage out of an existing international marketing network. That is precisely what Honeywell High-Tech Trading Company and AMF Trading Company are doing,

BEST COPY AVAILABLE

signing agreements with a few other manufacturers in product sectors very close to their own. This strategy involves at most a marginal investment in hiring two or three technical specialists, and certainly very little risk. If anything, the marketing representatives simply sell another product to the same list of customers. In the case of Stephens, a financial conglomerate, the company has simply made effective use of an ongoing, established relationship with an Indonesian-based financial organization, the Lippo Group. On both sides of the Pacific, these two companies have long had extensive networks with business clients, and so they hired marketing staffs to pursue two-way trade.

The second corporate cluster is a growing group that includes General Motors, Rockwell International, and now General Electric. These companies have created trading subsidiaries that are entirely devoted to countertrade operations and that serve only one client, namely the corporate family of divisions and subsidiaries. As countertrade operations, obviously they are focused on Third World and Eastern European markets. The separate subsidiary structure for the ETC provides a method of housing in one place expertise and worldwide contacts that can serve the larger corporate organization. Interestingly, General Electric, which set out to pursue

BEST COPY AVAILABLE

a piggyback approach, carrying other manufacturers' lines, decided recently to shift strategy and make its ETC strictly an in-house countertrade operation.

The third corporate cluster has only one member, and that is Sears Roebuck. Sears has pursued an investment strategy, acquiring existing firms in the U.S. and structuring joint ventures with American and overseas firms in trading and trade services, as well as consulting. Countertrade was part of its plan as was piggybacking on the Sears worldwide network of suppliers.

Secondly, the exporters that have received Commerce Department certification. The numbers change almost daily, but at least 65 applications have been received and about 40 have been approved. Some of the firms seeking certification appear to have done so for the public relations value, but others clearly feel that the added protection from antitrust lawsuits is a useful asset.

Most of these firms are small, a number are brand-new, including a group of dentists in St. Louis that decided to set up a firm to sell medical equipment and services in Third World nations. Because the companies involved are small, the potential impact on American exports

BEST COPY AVAILABLE

clearly will be modest for a while. Some major corporations may get certified one of these days. Quite a few of them have consulted with Commerce and I know several that are exploring the idea within the context of engaging in piggyback operations or in handling offset operations required by foreign customers.

Just a few examples suggest the range of organizations responding to the 1982 law. A farmer rice cooperative was able to develop a larger network of co-ops in order to bid on a sizeable sale in South Korea that would have been beyond the capability of any one member of the larger group. Commerce gave them an accelerated certificate to bid quickly on the sale. A Mississippi-based catfish producers association set up an ETC for its four member-companies, with certification, to permit the group to engage in joint marketing operations, including participation in a Japanese food show.

The Virginia Port Authority has created its own ETC, known as VEXTRAC, and it has been certified. Perhaps one of the most interesting new trading groups to get certified is a Los Angeles-based outfit called United Export Trading Company, whose ten member-investors each has a trade background. One of the ten is a bank, however, the Bank of San Pedro, located in Los Angeles harbor. The bank sees the ETC as a marketing tool.

BEST COPY AVAILABLE

The third group of new ETCs consists of the state and local governments, many of whom are exploring the contributions that a publicly-owned institution can offer. Two have gone forward, the New York-New Jersey Port Authority, which has created XPORT, a trading organization serving smaller firms in the bi-state area, and the Virginia Port Authority with its VEXTRAC.

The New York-New Jersey ETC has begun to develop an export financing role. It pioneered the Eximbank's new export credit insurance umbrella policy and it is hopeful that in 1985 the legislatures of the two states will approve a law giving it a significant direct financial capacity. Meanwhile, it has a $500,000 fund that serves as a prototype for a discount loan program.

One other port authority in Portland, Oregon, is moving to establish an ETC, and the Mississippi state legislature passed a law in June that authorized its development agency to develop an ETC. A dozen other state and local governments have been studying the idea.

Fourth, and most important, are the bank ETCs now emerging. So far 32 banks have applied to the Federal Reserve, and 28 have received approval. Twenty-six bank ETCs are being developed since three of those approved have decided to do a joint venture.

BEST COPY AVAILABLE

The banks have pursued ETCs with two orientations in mind, and the results have been shaped by those orientations. First is a small group of very large institutions -- Citicorp, Chase Manhattan, Manufacturers Hanover, and Bankers Trust -- that have seen the ETC law as an opportunity to devise new techniques of export credit. These banks see in their new ability to take title to goods a chance to pursue some packaging of deals that was not possible before.

The second bank group -- and it is by far the larger of the two -- sees the new ETCs as a method of diversification. While this group is more varied, including large and small banks, it does include some major institutions, among them the Bank of America, Security Pacific and First Interstate in California, and State Street and Shawmut Bank in Boston. This group of banks is pursuing what I would call the development of an old-fashioned trading company, offering clients the development of overseas distributor networks, monitoring those networks, undertaking market research, helping redesign products in light of that research, and offering or arranging such ancillary services as transportation and insurance. This is an established pattern for export trading companies or export management companies and most banks are pursuing that pattern.

BEST COPY AVAILABLE

The typical bank setting up an old-fashioned ETC has hired a specialized staff of experienced traders, usually with experience in single field or industry sector. Security Pacific, for example, is stressing food processing and medical equipment exports and has brought on board experienced traders in these sectors. Some banks have hired only two or three people so far, while at least one has hired about 30 or 35 new staff members.

While some banks are going it alone, others are considering joint ventures. In New Jersey, three banks have teamed up to form Bancorps' International Trading Co., or BITCO. In Providence, RI, Fleet Financial, is pursuing joint ventures and acquisitions with banks and existing marketing firms, and has referred clients to Honeywell High-Tech.

Many bank ETCs expect to engage in countertrade operations at some point, but few will engage in trade finance directly, aside from those that were set up just for trade finance purposes. Most others will refer export clients to their affiliated banks for trade credits, at least giving these the right of first refusal.

BEST COPY AVAILABLE

To evaluate what has happened in light of the 1982 law, I think the record is positive and encouraging. Take the banks. The total universe of possible bank ETCs is probably about 350, which is the number of master agreements the Eximbank maintains with U.S. banks. We now have 32 banks establishing ETCs or about 10 percent of that total, not a bad record for entry into a brand-new field for institutions that are of necessity cautious. Two years ago at a trade conference in New York, 60 banks were present, and, when asked for a show of hands on which were considering ETCs, not one responded. Today 32 are moving forward one way or another. It will take another year or possibly two to see just how much business the banks will really do, which ultimately is the standard by which their efforts will be gauged. For the moment, however, there is a real flurry of institution-building.

The state and local government move into ETCs has been modest, but it should be remembered that these institutions face the issue of not competing with the private sector. Very likely, however, they will provide useful services to private exporters, and that will be a positive response to the goals set by the 1982 law.

BEST COPY AVAILABLE

The Commerce Department antitrust certifications keep increasing in number, suggesting growing national export awareness. Many of the newer firms among these certified groups may never get off the ground, but the very fact that many new groups have been formed for export purposes is testimony to the psychological impact of the law.

Finally, a few hundred million dollars in new exports should come out of the large corporations that are pursuing a piggyback strategy over the next two to three years. While they do not owe their existence to the law, my impression is that they are responding to the same growing national awareness of exporting that inspired passage of the 1982 Act itself.

Mr. BONKER. Thank you, Mr. Barovick.

### ETC ROLE IN LICENSING PROCESS

Mr. Roach, I know you have to leave, so we will begin with you. The first question I have concerns you primarily, but the others as well, since everybody is talking about high technology these days, and everybody wants to get into the export of technology. If someone is involved with a high-technology manufacturer and has to deal with the agony of our licensing procedures—the delay, the complexity—what happens when you put in a middle person? Will the banks take title to technology in the course of exporting or not?

A company like Honeywell, or Tektronix in my area, has set up a whole division to deal with licensing procedures. So here you are going to have a potential exporter—I am talking now about banks who are providing this service—and they have, of course, the knowledge of the technology and the control list, and how you identify the level of technology for licensing purposes and so forth. Isn't this going to be a terribly complex area for banks to get into in terms of trying to figure out who asks to get a license, for what product, for what destination. Because if you are going to ship to Cocom countries, that involves one list of requirements. If you are going to export to free world countries, other conditions apply. And so on and so forth.

It is going to be tough enough for you just as an exporter, in an in-house operation. I wonder how these banks are going to get into the export of technology.

BEST COPY AVAILABLE

Mr. ROACH. I don't have any knowledge of what the banks are doing. But I guess it is just this simple. If you are going to acquire a customer and provide them with a service, you are going to have to have the competency to do that. And if you don't do it, then you will fail.

Mr. BONKER. OK.

Mr. Gomperts.

Mr. GOMPERTS. I would just like to answer in two parts. In the first place, the bank is not going to do it. The bank trading company is going to do it.

Mr. BONKER. I should know better.

Mr. GOMPERTS. To be an effective trading company, that company has to have that in-house expertise and ability to handle that. Part of the job of the bank trading company is to represent a group of small manufacturers who do not have the kind of expertise that Honeywell does and cannot individually go out and get the expertise to—each for themselves to get the export license. That is what a bank trading company can do for these manufacturers who have not participated in export in the past.

Mr. BONKER. Mr. Becker, do you agree?

Mr. BECKER. I do. In our case, because we have been dealing with export licensing situations for sometime, it is not going to be a problem. But I would raise this issue—because the act that you referred to, the Export Administration Act, which has not been resolved in terms of all the issues on distribution licenses, will an export trading company in its own right be able to apply for a distribution license? And if that is——

Mr. BONKER. Are you asking me a question?

Mr. BECKER. If that comes out in the final version of the to-be-passed extension of the act, then we would feel very comfortable handling it that way.

Mr. BONKER. I don't believe that anything in the legislation specifically prohibits a training company from being granted a distribution license.

Mr. BECKER. Thank you, Mr. Chairman. We haven't tried it yet, but we are very happy to think it can be done.

Mr. BONKER. The Department of Commerce has flexibility in issuing distribution licenses. If they feel that a trading company meets the criteria and won't end up with diversion problems, I suppose it can issue a distribution license to an ETC.

Mr. Barovick?

Mr. BAROVICK. In my survey, one of the things I came across on this issue was that the banks are hiring law firms to guide them on the export administration.

Mr. BONKER. Mr. Roach, you certainly don't need to benefit from anything that is in the Export Trading Company Act, since you are pretty much in-house. You can set up an ETC regardless of whether or not we pass the act. But would you have done so?

Mr. ROACH. I don't think so.

Mr. BONKER. So what in the passage of this act——

Mr. ROACH. I think the very fact that it drew our attention to it and caused us to study it and analyze it, and then we saw some strategic value in doing it. But I seriously doubt that we would

BEST COPY AVAILABLE

have done it. Perhaps we might have. The record is, it forced us to look at it and analyze it and that is what happened.

Mr. BONKER. And all that started with the House Export Task Force.

Mr. ROACH. Exactly.

COUNTERTRADE

Mr. BONKER. That is very interesting. You know many large corporations have set up ETC's—Rockwell, in my area, Boeing is looking at it, Weyerhaeuser, and so forth. And yet people will identify that action with the law that we just passed. It is a combination of things—a new consciousness about the concept of ETC's, and also the emerging realities of international trade. You are old-timers on trade, I am a newcomer. I rather imagine that countertrade may have been around for awhile, but it is far more prominent these days than in the past, because people have currency shortfalls and they have to wheel and deal in order to get what they want.

What do you see coming, Mr. Roach, with countertrade? We talked about this a few moments ago. You are in a very specialized area. You want to sell something to Romania that is permissible by our licensing procedures, and you get something in return. You still say that you don't have to handle these things, but you do have to handle them, don't you if you are going to sell generators to Yugoslavia?

Mr. ROACH. Our experience is when you are dealing with high-technology products, the pressures for countertrade are not as great as they might be for commodities. So, one doesn't necessarily have to deal in countertrade all the time.

Mr. BONKER. Mr. Roth.

Mr. ROTH. Thank you, Mr. Chairman.

Mr. Roach, what percentage of your business is engaged in countertrade now?

Mr. ROACH. Very, very minimal. Less than a percent.

One is not obligated to engage in countertrade. That is a form of payment. And beforehand, you can determine whether or not you want to engage in that at all, or walk away from the deal. So that you can be rather selective. There is no point in being suicidal.

Mr. ROTH. I think I have a flavor for the problems with which you are confronted. I was in the real estate business before I came to Congress and involved in many exchanges. You had to bring your lawyer and your accountant. You had to do a threefold sales job—you had to negotiate with the buyer, the seller, and then you had to go sell the deal to the banks. So, I know how complicated it can get just on a small scale. In fact, I still own real estate in Wisconsin—somebody always doesn't take the last product

Wisconsin is the 14 largest trading State in the Nation. One of the problems we have in interesting Wisconsin businesses with the ETC organizational framework is that they like to keep their own identity. With the ETC concept, companies often feel that corporate identity is lost in the process. So, we have a problem to overcome in that area. But I think we are making some progress.

BEST COPY AVAILABLE

IMPEDIMENTS TO INCREASED TRADE

My question concerns the big trade deficits we have today. What are three or four things that we are going to have to do to improve our trade picture? Obviously ETC's alone are not going to do it.

Mr. ROACH. As I mentioned in my testimony, I think the dollar problem has got to be the biggest single problem that we have. As long as that hangs as a shadow over us, we are going to have one difficult time competing in the world markets.

The other thing is the Export Administration Act. We have got to get a set of rules that everybody understands, that we can operate by, and get some stability. We cannot have ridiculous regulations that restrict American business and therefore allow business to go to other nations by default.

Mr. ROTH. If it were up to me, Mr. Roach, we would have had an EAA Act a year ago.

Mr. ROACH. I don't say this in the way of complaining. I understand how the system works. But I think those are the things we have to pay attention to and work on. And it doesn't do any good, you know, to promote trading companies at the same time we move four paces back because of actions that either involve regulations or concerning the dollar. But I understand the forces at work, too, that we have to somehow get our act together if we indeed want to compete in world markets.

As I mentioned, again in testimony, I think the protectionism, that is the wrong road to go. We are either going to be traders and recognize that you have to buy and sell and compete, or else dig a hole and climb in and pull it in after us.

Mr. ROTH. I sympathize with what you are saying about the dangers of protectionism. Free trade sounds great in theory. But when you look at the practical world, the human costs emerge. Wisconsin is a big trading State but we are losing many jobs. For example, we used to have a formidable shoe industry, and it is devastated now. And that is only one area. I can name you many, many other industries that have been devastated. So I don't know how rigidly we can afford to stand by the theoretical principles of free trade.

Mr. ROACH. I think what we have to do is analyze that and see whether the devastation has taken place because we are not competing and not able to compete in a free market, or whether we are being taken advantage of by our trading partners. And I think there is plenty of legislation in the system, if it is the latter case, whereby we can move with trading partners to try to adjust that. I see protectionism as a poor choice.

Mr. ROTH. So do I. But my visceral reaction is that we are going to see more protectionism in Congress, particularly if we start heading into more difficult economic times.

Mr. ROACH. I understand the pressures are building that way. That is why the dollar is so poor. If we can get that straightened out, that will be a big relief.

Mr. ROTH. Well frankly, I doubt that we will see much downward movement on the dollar because people have such great confidence in it right now.

Mr. ROACH. Just because the tasks are difficult doesn't mean we shouldn't address them. I understand they are all difficult.

BEST COPY AVAILABLE

Mr. BONKER. Mr. Roach, I would like to offer a comment on the issue of protectionism. Congress has been rather restrained on protectionism—with the exception of domestic content legislation, which eveybody knows isn't going anywhere. All in all, we have been fairly quiet. I think the issue is more unfair trade practices and how we deal with those questions. Sometimes we have to look the other way, particularly when it comes to the Latin American countries. But if another country is dumping or indulging in subsidies and it is bringing injury to domestic industries, it is not fair. I think Americans are just calling for fairness, whether it is from Japan or some other countries. I think our laws ought to be crafted in such a way that we encourage fairness in trade.

Mr. ROACH. I would agree with that.

Mr. BONKER. That is where we are. I understand that you have to go.

Mr. ROACH. Thank you very much.

Mr. ROTH. Thank you very much for your testimony.

Mr. BONKER. Thank you, Mr. Roach. I think you have given us some meaningful comments today.

I would like to focus a little bit on banks here. We have had other testimony about the 51-percent requirement, which is emerging as a potential obstacle against full participation by the banks in trading companies. That is also a matter that is going to have to be taken up by the Banking Committee. We are going to be recommending some changes from this committee. It is not only just the regulatory issue that has been established now by the Federal Reserve Board, but I think it is an attitudinal problem. Everybody feared that the Department of Justice would be the reluctant agency or department because of the antitrust laws, since there is kind of an institutional commitment to those antitrust laws. Actually Commerce and Justice have been very cooperative in helping with the formation of ETC's, but the Federal Reserve Board has been hostile. They don't like it, they don't want to go along with it. They take a very hard-line position when it comes to these regulatory areas, as you have seen. So I think we are going to have to legislate changes.

### NEW YORK-NEW JERSEY PORT AUTHORITY

Now, Mr. Becker, I have looked all through the law, and I cannot find port authorities mentioned. I know that it was not our intent, and I don't think it is anywhere in here, or in the committee reports. Certainly it was not our purpose that they compete with the private sector.

I always thought the New York-New Jersey arrangement was written in such a way that it wasn't supposed to compete. It was supposed to complement the private sector.

Mr. BECKER. If I may, Mr. Chairman, that was part of the debate I had with Peter Goldmark. They claim that the port authority, that they are offering services that private sector companies either are not willing to offer or do not choose to offer for one reason or another. The problem is the port authority will undertake an assignment on the basis of doing whatever has to be done with no

BEST COPY AVAILABLE

commission to be paid to the port authority until the first sale has been made.

Well, we have to look at the bottom line. We have to charge fees, and we have lost potential customers, because they have gone to the port authority instead of to our company because they are obviously getting a free ride. And every time I pay my bridge and tunnel tolls this actually galls me. And I have said this to Peter Goldmark, and the issue remains as it is today, and we continue to discuss it.

Mr. BONKER. Actually you could look at it another way. If providing export services is a profitable venture for the banks, it will be profitable for the parts, and in that case your tax money is being wisely invested.

Mr. BECKER. If it turns out to be profitable for the port, I would agree with you. But I think it will be a long time before it will be profitable for the port authority the way they are spending money today.

Mr. BONKER. Are you saying that the port or the trading entity is not being administered in a way that is sound?

Mr. BECKER. No, not at all. It is a high-overhead operation. But they are competing directly with the private sector. I believe that is why Trenton and Albany refuse to give them the legislation they wanted. I have copies with me of the legislation that is now being considered which, in effect, urges the port authority to deal with private lenders, if they need export financing rather than to go to the States for bond financing, which is what they had asked for in the beginning. That is out in New York and New Jersey.

But what remains is the fact that in their trade facilitation program they are offering subsidized services to companies which in many cases we find difficult to condone. That's all.

Mr. BONKER. You might want to submit some recommendations to this committee. We have established limits on what banks can do and how they can participate, but we don't have any limits on port authorities. If this gets to be a serious problem, then I think the committee——

Mr. BECKER. Frankly, I hope we can cooperate with them as I indicated in my testimony, and we continue to talk.

Mr. BONKER. Our experience out West is that the ports have not really been anxious to get involved. I have encouraged them; but in one State there is no enabling legislation, and in another State they passed enabling legislation, but the port has not moved very aggressively. You cited two instances—what is happening in the other instance, Mr. Barovick?

Mr. BAROVICK. I understood that Portland, OR, was taking some steps. I don't think they have set up a trading company. The State of Mississippi passed legislation a couple of months ago authorizing the State development agency to participate in some way in a trading company. That is about it.

Mr. BONKER. OK.

### BANKING VERSUS TRADING

Mr. Gomperts, Mr. Becker, both of you come from trade backgrounds, and not banking bankgrounds. You have made that abun-

BEST COPY AVAILABLE

dantly clear. Is that what is happening now? When banks set up trade corporations through their holding companies, are they acquiring expertise through management firms, rather than using some in-house expertise in international finance to proceed in this new dimension?

Mr. GOMPERTS. I cannot speak for banks generally. I know what ours is doing. I would—I have publicly made the statement before that any bank that relies upon bankers to run an export trading company, the company will fail.

Mr. BONKER. Why? That is a pretty hard statement.

Mr. GOMPERTS. That is a hard statement, I understand that. But it has to do with the fact that banking is a very, very different business from trading. As I believe Mr. Becker said, trading has certain risk-taking activities in it, and banks don't consciously go into risk-taking activities. They might end up with risk-taking activities, but they don't go into it for that purpose.

It is a different kind of business that takes a different attitude and different mentality. I believe those bank trading companies that will be successful will be those who turn for the activities of trade to people with experience in trade.

Mr. BONKER. Mr. Gomperts, before you were acquired, you had your own trading companies.

Mr. GOMPERTS. Yes, sir.

Mr. BONKER. Based in New York?

Mr. GOMPERTS. In San Francisco.

Mr. BONKER. Were you a trade management firm?

Mr. GOMPERTS. No, an export trading company. But as typical of the import and export traders, prior to the establishment of the ETC and the bank holding companies getting into it, we were a relatively small trading company.

Mr. BONKER. Small and specialized.

Mr. GOMPERTS. And specialized. Not heavily financed.

Mr. BONKER. In San Francisco, approximately how many small export companies, or management companies, are around?

Mr. GOMPERTS. I would say in the San Francisco Bay area there are probably 50.

### ETC'S ENCOURAGING NEW BUSINESS

Mr. BONKER. When this committee was considering the legislation and it became clear we were going to draft an export trading company law allowing banks for the first time to engage in this activity through their holding companies, what was the feeling among your colleagues?

Mr. GOMPERTS. The small importers and exporters? There was a good deal of fear that the bank trading companies would wipe them out. And long before I joined Bank America World Trade I said I did not see them as competitors to the small companies.

Mr. BONKER. You were a minority voice.

Mr. GOMPERTS. I was a minority voice, perhaps. Perhaps I had given it a little more thought than they had, because an organization like a bank trading company simply cannot compete in the kind of business that those exporters and importers are doing.

BEST COPY AVAILABLE

Mr. BONKER. Are you saying those earlier fears were justified? What is the feeling now?

Mr. GOMPERTS. I think most of the people who are in import-export have found that the bank trading companies have not disturbed their trade whatsoever.

Mr. BONKER. Are you saying that we have a bigger pie to slice up?

Mr. GOMPERTS. I can say as far as Bank America World Trade is concerned we are not going after the business that has been done for years, for decades by the importers and exporters. We are trying to encourage new business.

Mr. BONKER. Why?

Mr. GOMPERTS. Let us just take our own company. We have to have an operations officer from the bank. We have an office manager. We have a legal office.

Mr. BONKER. But you have to deal in volume, and volume has to come from somebody else.

Mr. GOMPERTS. It has to be volume, but it has to be volume of a variety and a—a higher markup than the smaller companies. You know, I ran a company with four people and we did $30 million worth of business. Here we have 30 people and we may be doing $4 million worth of business. It is in a totally different scope. We have got to go after the bigger, the more complicated business, the business that requires financial capability and the business that requires the worldwide, global potential. And that is the kind of business that the importer-exporter simply cannot even consider.

Mr. BONKER. Mr. Becker, do you have any comments?

### ROLE OF SMALL- AND MEDIUM-SIZED ETC'S

Mr. BECKER. I would like to, for the record, say something that has not been touched upon this afternoon. It relates to questions raised by Mr. Roth and by you. The role of small- and medium-sized companies. That is our focus. And if you look at the statistics, and we all know them, the major corporations in the United States are responsible for over 80 percent of our trade. It is a well-known fact. The thing that disturbs me, Mr. Chairman, is that so many of the small- and medium-sized companies we talk to, customers of our three banks, are just not interested in exporting even if they are given the opportunity to export.

Several firms have said to me the economic situation has improved in the United States, thank you very much, we are not interested. I find this disturbing. Until more small- or medium-sized companies get involved I don't think we are really going to make a significant dent in the trade deficit.

Mr. BONKER. Are you saying, Mr. Becker, that when you locate a potential buyer and you try to match it up with a manufacturer, the manufacturer is saying thanks but no thanks?

Mr. BECKER. I can tell you very specifically I talked to a company the other day in the health equipment field, one of the leaders in the field, and I said would you be interested in talking about other areas outside the United States and they said, thank you, no more. We don't care for any more distributors, we are satisfied with what we are doing now.

BEST COPY AVAILABLE

Mr. BONKER. Is that the rule or the exception?

Mr. BECKER. I have run across that quite frequently.

Mr. BONKER. Mr. Gomperts.

Mr. GOMPERTS. I would say in our primary activities on the west coast and California we have not run into that. We have run into people who say we don't want to do the export ourselves, but if you take the burdens of export, we want to see our products go into export.

Mr. BECKER. I believe this legislation is so important, particularly as it relates to small- and medium-sized companies, and they represent 95 percent of the customers of our three banks. They are delighted to have an export trading company come to them and say we will take title to the goods, we will provide the necessary financing, we will handle all the paperwork, we will do this, that and whatever it takes.

Mr. BONKER. It doesn't always work that way.

Mr. BECKER. No. But we are prepared to do that. And the response of those companies that are interested in export business has been very, very positive to this new concept where bank trading companies can offer that facility.

Mr. BONKER. We had a workshop in my State a few weeks ago for small and medium sized wood products manufacturers. The wood products industry can no longer depend on the domestic economy for a variety of reasons. They realize if they don't get into exporting, they have to shut down. Many are shut down already. We had an all-day work session with three major panels, representing a lot of expertise. The panel that everybody was interested in, however, was the panel on bankers, or people representing banks, and bank trading companies. These manufacturers sense that their economic future, perhaps their economic survival, rests not only with exports but with the means of exporting. They see those services coming from the banks, and thus are not making the effort to organize among themselves and set up an ETC in order to get into other markets.

Mr. GOMPERTS. Mr. Chairman, there was an article in yesterday's Portland, OR—I don't know the name of the newspaper—that BankAmerica World Trade had their first shipload of logs going to the People's Republic of China. All of those logs were gathered from small holders who had never before been able to get together and do the export. That is the idea, that is what I think we can serve.

Mr. BONKER. Of course, for me it is a good news bad news sort of thing if we send logs and not finished products.

Mr. GOMPERTS. We also have finished product interest in wood products. We are working on that very hard.

Mr. Chairman, I have a 5:05 plane to get back to San Francisco.

Mr. BONKER. OK. Thank you very much for your contribution today.

Mr. Barovick, do you have anything to offer in terms of small companies and bank trading corporations? My vision as the author of this bill in the House was that five of these mills, for example, would go out, form an ETC, and hire an export specialist who knew something about wood products and could really help to facilitate new opportunities for these small mills. But they are not doing

BEST COPY AVAILABLE

that. It is not happening in the high technology industries out there, and there are a lot of small high technology firms. It is not happening in the wood products industry. They are not showing the initiative. This is true nationwide. It looks like the desire to export is there, but they are looking to the banks to help make those opportunities happen.

Is that what you found in your survey?

Mr. BAROVICK. Rainier Bank, in Seattle, set up an international trading company to do joint ventures. One of them is a joint venture with a large California food broker.

Mr. BONKER. Food processor?

Mr. BAROVICK. Food broker, Crown Produce. And then the other one is called Rainier Match Corp., through which they are hoping to serve as a high technology consultant. Those are the only ones I know of in that area.

Mr. BONKER. I probably shouldn't say this, but when I look at the Rainier trading company, I see a picture frame with nothing in it. Maybe that is a premature judgment. On the west coast, the banks have moved very quickly to form ETC's, but as a defensive move. They are fearful about what you guys are going to do out there. And Citibank and others—they feel that that will be their entry to the Pacific, through ETC's. But I don't see a lot happening. Maybe it is too early. Is it too early?

Mr. BAROVICK. I think so. Certainly nationwide it is too early. I think there is a little bit of business being done already by the bank ETC's.

Mr. BONKER. I am talking about my regional banks out there.

Mr. BAROVICK. It is too early.

Mr. BONKER. Too early to be judgmental.

### BANK ETC'S COMPETING WITH CUSTOMERS

Mr. Becker, what happens when bank trading companies get into trading in a big way and they end up competing with their customers?

Mr. BECKER. Well, that probably would not happen in our case because, as I indicated, Mr. Chairman, most of the customers of our three banks are small- to medium-sized companies. We are working with some of the larger ones—Lenox China, and some other well-known household names. But in this case, we are offering a service that is in addition to what they are capable of doing in a particular market. I just don't anticipate that happening in the market area that we serve.

Mr. BONKER. If you are serving small and medium-sized high-technology firms, and IBM happens to be a customer that has a market in France or Sweden, is it not possible by that, providing all these services including export licenses, you are, in effect, making more competition in that particular market for a major customer like IBM?

Mr. BECKER. You raise a good example, because you singled out IBM. We have just quoted IBM personal computers and associated peripherals to a Hong Kong trading company, ultimate destination mainland China. We will be buying this equipment from a customer of one of our banks. That customer is an established IBM dealer.

BEST COPY AVAILABLE

In the agreement that that dealer has with IMB that they must check with IBM World Trade in this particular instance, but I believe under the law and under the agreements that that dealer can sell to an export trading company even though he knows we are going to export the product, and IBM knows we are going to export the product.

You might say isn't IBM concerned about losing business in mainland China to what we might be able to do through a trading company in Hong Kong. I doubt it. I think we may just be augmenting what IBM might ultimately be able to do there later on. We have not seen it happen. I know what you mean, but we have not encountered the problem yet.

Mr. BONKER. Mr. Barovick, I really appreciate having your two different categories, because I would have put them all in the same grouping. You really feel these will be the two distinct areas of bank filings with the Federal Reserve Board in terms of trade activity?

Mr. BAROVICK. These are the two so far. There may be some merging of the two extremes.

Mr. BONKER. How about bankers' banks——

Mr. BAROVICK. There are none so far.

Mr. BONKER. I thought that in Tennessee, or Kentucky, someplace five or six banks had come together to form an ETC.

Mr. BAROVICK. I have not run across that. There is First Kentucky, or Kentucky National that set up an ETC. There is a Cleveland Society Bank and CIFCO, a large manufacturing company set up a joint venture. They are looking for 10 other manufacturers to come in on a joint venture.

Mr. BONKER. OK. So you feel the most revolutionary aspect of the ETC legislation is going to be with the banks.

Mr. BAROVICK. So far it certainly has been.

Mr. BONKER. The banks have not earned widespread admiration from the American public on their international dealings in the last several decades, given the state of the debt crisis and their rather indulgent lending practices in the last 10, 12, 15 years.

Many banks are in a fairly perilous condition—especially if some of these countries go to nonperformance status on their obligations. You may not be the right person to ask, and Mr. Becker is too biased to ask, but, is it really the right time to be extending new commercial authorities to banks when their track record on lending practices has not been that good?

Mr. BAROVICK. Well, this is a completely different field from what they have gone through, the big banks have gone through in lending to Third World borrowers. They have also hired the expertise—the same bankers who ran into trouble as lenders are not the same ones who are running the trading companies. They have hired traders in most cases.

Mr. BONKER. Mr. Becker and Mr. Gomperts are going to bail them out on any future——

Mr. BAROVICK. Also, I think the bank trading companies are so far small operations.

Mr. BONKER. Well, I think it is going to be very interesting. We have to do something. The trade deficit is going to reach $125, $130 billion this year, and the pressure is going to be on Congress to do

BEST COPY AVAILABLE

one of two things. We either have to export more, or we have to go the route of protectionism. This is one way to export more—one of the few things Congress has done to encourage more exporting. That is why I think we have to be cautious and keep some limitations so there are no abuses. On the other hand, this is no time to inhibit our export potential.

I'd like to thank you both for your patience. I appreciate very much the two of you staying this long and offering such excellent testimony today.

The subcommittee stands adjourned.

[Whereupon, at 4:35 p.m., the subcommittee was adjourned, to reconvene subject to the call of the Chair.]



BEST COPY AVAILABLE